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IN THE

Supreme Court of the United States

OCTOBER TERM, 1932

No. 732

RICHARD REID ROGERS, *Petitioner,*

against

GEORGE W. HILL, C. F. NEILEY, V. RIGGIO AND THE AMERICAN TOBACCO COMPANY, *Respondents,*

and

A. C. MOWER AND CHARLES A. PENN (deceased), *Defendants.*

RICHARD REID ROGERS, *Petitioner,*

against

THOMAS R. TAYLOR AND THE AMERICAN TOBACCO COMPANY, *Respondents.*

Consolidated Cause.

BRIEF OF RESPONDENTS IN OPPOSITION TO PETITION FOR CERTIORARI

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CORPORATE PRESS, INC., NEW YORK CITY

INDEX

PAGE

RELIMINARY STATEMENT 1

UMMARY OF REASONS AGAINST THE ALLOWANCE OF THE WRIT PRAYED FOR 4

RGUMENT:

I. The first mandate and decision of the Circuit Court of Appeals constituted a final determination of all the issues in the cause, and the time to apply for a writ of certiorari expired three months after June 29, 1932, the date of entry thereof 5

I. The application for a writ of certiorari from the second decree of the Circuit Court of Appeals presents no reviewable question 8

I. No special or important reasons are shown for the exercise by this Court of its discretionary powers of review 9

V. The decision of the Circuit Court of Appeals on the first appeal, sustaining the validity of the By-law, which the petitioner did not seek to review, is in harmony, not in conflict, with the applicable New Jersey decisions 10

A. The question presented by petitioner's reason 1 has been decided adversely to his contention by the highest court of New Jersey 10

B. The question presented by petitioner's reason 2 has been decided adversely to his contention by the highest court of New Jersey 13

V. Reasons 3 and 4 assigned by the petitioner involve familiar questions of corporate management which this Court has repeatedly declined to review 15

NCLUSION 18

Table of Cases Cited

PAGE

Aspen Mining & Smelting Co. v. Billings, 150 U. S. 31, 37 9
Atwater v. Elkhorn Co., 184 N. Y. App. Div. 253, 258 .. 17

Backus v. Finkelstein, 23 Fed. (2d) 531, 537 17
Baumohl v. Goldstein, 95 N. J. Eq. 597 15
Bennett v. Millville Improvement Co., 67 N. J. L. 320 ..... 11, 12
Booth v. Beattie, 95 N. J. Eq. 776; affd. 95 N. J. Eq. 776 13
Bostwick v. Brinkerhoff, 106 U. S. 3 6

Christian Feigenspan, Inc. v. Bodine, 264 Fed. 186, 190, affd. 253 U. S. 350 14
Church v. Harnit, 35 Fed. (2d) 499; cert. denied 281 U. S. 732 ..... 13, 15, 17
Collins v. Hite, 109 W. Va. 79 17
Costello v. Thomas Cusack Co., 96 N. J. Eq. 95 13

Decatur Land Co. v. Palm, 113 Ala. 531, 537 17
Dubilier Condenser Corporation v. Radio Corporation of America, No. 396, October Term, 1932 7

Farmers' National Bank v. Wilkinson, 266 U. S. 503 .. 7

Gardner v. Butler, 30 N. J. Eq. 702 17
Godley v. Crandall, 153 N. Y. App. Div. 697, 710 17
Goldwyn Pictures Corp. v. Goldwyn, 296 Fed. 391 8
Gotham Can Co. v. United States, 281 U. S. 706 7
Gulf Refining Co. v. United States, 269 U. S. 125, 136 ... 6, 7

Harker v. Ralston Purina Co., 45 Fed. (2d) 929; cert. denied 284 U. S. 619 ..... 13, 15
Hooper v. United States, 274 U. S. 743 7
Humphrey v. Baker, 103 U. S. 736 9

In re Griffing Iron Co., 63 N. J. L. 168; affd. 63 N. J. L. 357 14
In re Sanford Fork and Tool Company, 160 U. S. 247, 255 7

PAGE

Kavanaugh v. Commonwealth Trust Co., 223 N. Y. 103 107 15

Lillard v. Oil, Paint and Drug Co., 70 N. J. Eq. 197, 206 ..... 14, 17
Lowman v. Harvey R. Pierce Co., 276 Pa. 382..... 17

Mackall v. Richards, 116 U. S. 45, 56 9
Maison Dorin Societe Anonyme v. Arnold, 296 Fed. 387 8
Matter of Rosenberg, 213 N. Y. App. Div. 167, 169 13
McGourkey v. Toledo, 146 U. S. 536 6
McKey v. Swenson, 232 Mich. 505 17
McMahon v. Burdette, 106 N. J. Eq. 79, 80 17
Mitchell v. United Box Board & Paper Co., 72 N. J. Eq. 580, 585 17
Morton v. United States, No. 638, October Term, 1932 .. 7
Mutual Life Insurance Company v. Hill, 193 U. S. 551.. 7

Neff v. Gas & Electric Shop, 232 Ky. 66 13
Nichols v. Olympia Veneer Co., 139 Wash. 395 17

Putnam v. Juvenile Shoe Corp., 307 Mo. 74 ..... 13, 17

Ransome Concrete Machinery Co. v. Moody, 282 Fed. 29 ..... 13, 17
Raynolds v. Diamond Mills Co., 69 N. J. Eq. 299, 312.. 17
Rhode Island v. Palmer, 253 U. S. 350 14
Richardson v. Devine, 193 Mass. 336 15
Roberts v. Cooper, 20 How. 467 7
Rogers v. Guaranty Trust Co., et al., 53 Sup. Ct. 295 ... 16
Rust Land & Lumber Co. v. Jackson, 250 U. S. 71, 76 ... 7

Schall v. Althaus, 208 N. Y. App. Div. 103, 106 17
Scott v. P. Lorillard Co., 108 N. J. Eq. 153, 155; affd. 109 N. J. Eq. 417 ..... 14, 17
Smith v. Bedell Bros., 84 N. J. Eq. 268; affd. 84 N. J. Eq. 509 13
Sotter v. Coatesville Boiler Works, 257 Pa. 411 17
Stewart v. Salamon, 97 U. S. 361 9
Stratis v. Andreson, 254 Mass. 536 17

PAGE

Texas and Pacific Railway Co. v. Anderson, 149 U. S. 237, 242 9

Toledo Scale Co. v. Computing Scale Co., 261 U. S. 399 ..... 7, 8

Wight v. Heublein, 238 Fed. 321 17

Young v. U. S. Mortgage & Trust Co., 214 N. Y. 279.... 13

Zwolanek v. Baker Mfg. Co., 150 Wisc. 517 13

Table of Statutes Cited

UNITED STATES

Act of February 13, 1925, c. 229, Sec. 8(a), 43 Stat. 936, 940 (U. S. C. Title 28, § 350) 8

NEW JERSEY

General Corporation Act, § 1 (L. 1896, Ch. 185 § 1) 11

General Corporation Act, § 11 (Revision 1896, L. 1896, Ch. 185, § 11) 13

General Corporation Act, § 47 (L. 1896, Ch. 185, § 47 as amended by L. 1901, Ch. 110, § 2 12

FEDERAL EQUITY RULES OF PRACTICE

Rule 27, 226 U. S. 656 2

IN THE

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OCTOBER TERM, 1932

No. 732

RICHARD REID ROGERS, *Petitioner,* against GEORGE W. HILL, C. F. NEILEY, V. RIGGIO and THE AMERICAN TOBACCO COMPANY, *Respondents,* and A. C. MOWER and CHARLES A. PENN (deceased), *Defendants.*	Consolidated Cause
RICHARD REID ROGERS, *Petitioner,* against THOMAS R. TAYLOR and THE AMERICAN TOBACCO COMPANY, *Respondents.*	

BRIEF OF RESPONDENTS IN OPPOSITION TO PETITION FOR CERTIORARI

Preliminary Statement.

Petitioner, a stockholder of The American Tobacco Company, a New Jersey corporation (hereinafter called "Company") sought by this cause to obtain a decree declaring Article XII of its By-Laws invalid. That By-Law was

adopted on March 13, 1912, by practically the unanimous vote of all the stockholders present at a duly constituted meeting. No Common Stock and only 35 preferred shares voted against it (R., p. 76).

Article XII by its terms provided that it could be modified or repealed only by the action of the stockholders (R., p. 59). It provided for a 2½% participation by the President and a 1½% participation by each of five Vice Presidents in excess of the annual net earnings of the Company from certain specified sources (after paying the dividends on the preferred stock) over the amount which had been adopted as the amount of the net profits from the same sources for the year 1910 (R., pp. 23, 24).

The individual defendants became executives of the Company, entitled to compensation under the By-Law, years after it had been in operation (R., p. 13). They had no hand in its creation or adoption.

No attack was ever made upon Article XII, either in court or out of court, until March 31, 1931, when the first of these suits was instituted by petitioner (R., pp. 19, 83, 196).

Petitioner sought also to have all compensation paid to the individual defendants *under the By-Law* since, in some instances, as early as 1921, returned to the Company and, as alternative relief in the event the By-Law was held valid, to have the court fix the compensation of all present and future presidents and vice presidents beyond which no further or additional compensation could be paid (R., pp. 21-22).

The issues raised by the answer were:

1. Failure to comply with Equity Rule 27 (R., pp. 76, 77).

2. Approval by the stockholders of the payments made under the By-Law (R., pp. 78-81).

3. *Forum non conveniens* (R., pp. 81, 82).

4. Laches (R., pp. 82, 83).

5. Services of the individual defendants more valuable than any compensation paid and compensation a question of internal affairs (R., pp. 83-107).

Petitioner, after joinder of issue, made a motion in the District Court (1) to strike out each one of the five separate defenses; (2) for a decree declaring Article XII invalid, requiring the individual respondents to account for all payments made to them under that Article, and restraining the Company from making any further payments thereunder; and (3) in the alternative, for an injunction *pendente lite* restraining any further payments to any president or vice president under the By-Law (R., pp. 6-8).

The motion was heard on January 15, 1932 (R., p. 5). On March 18, 1932, the District Court rendered an opinion which stated (but gave no reasons for the conclusion) that its impression was that the By-Law was invalid; the opinion stated further that its view was only tentative because it did not have an adequate opportunity for investigation and reflection (R., pp. 5, 212).

On March 24, 1932, pursuant to that decision, an order was entered in the District Court granting petitioner's motion for an injunction upon the giving or waiver of a bond in the sum of $1,000 (R., pp. 214-216).

The respondents appealed to the Circuit Court of Appeals, which court directed a reversal of the decree of the District Court and disposed of all the issues in the case by its majority opinion which stated in part:

> "* * * The by-law is neither *ultra vires*, fraudulent nor illegal, and since it is not, courts must refuse intervention because they are powerless to grant it. Here the matter of salaries, like that of other corporation affairs, must be disposed of by the majority of stockholders and in the manner that their interests may dictate, and the action of the majority is binding upon all, whether approved or disapproved by the

> minority. * * * By-Law XII was properly passed and became a valid governing act of the corporation" (R., p. 233).

On June 29, 1932, the Circuit Court issued its mandate which reversed the order of the District Court and directed "that such further proceedings be had in said cause in accordance with the decision of this court * * *" (R., p. 241).

On July 8, 1932, the District Court, per MACK, *C. J.*, entered a decree based upon the mandate and decision of the Circuit Court of Appeals dismissing each of the bills of complaint upon the merits (R., pp. 242-243).

Instead of applying for a writ of certiorari, petitioner appealed to the Circuit Court of Appeals from the decree of the District Court entered upon the mandate and decision of the Circuit Court of Appeals (R., pp. 244-245), and the errors assigned on that appeal were:

> "1. The Court erred in dismissing the bills of complaint upon the merits.
>
> 2. The Court erred in failing to render judgment for the plaintiff [petitioner] for the relief prayed for in the amended complaint.
>
> 3. The Court erred in dismissing the bills of complaint solely upon the mandate and decision of the Circuit Court of Appeals" (R., p. 246).

On such second appeal, the Circuit Court of Appeals affirmed the decree of the District Court as having been correctly entered in conformity with its mandate and decision on the first appeal (R., p. 253).

Summary of Reasons Against the Allowance of the Writ Prayed For.

I. The first mandate and decision of the Circuit Court of Appeals constituted a final determination of all the issues

in the cause, and the time to apply for a writ of certiorari expired three months after June 29, 1932, the date of entry thereof.

II. The application for a writ of certiorari from the second mandate and decision of the Circuit Court of Appeals presents no reviewable question.

III. No special or important reasons are shown for the exercise by this court of its discretionary powers of review.

IV. The decision of the Circuit Court of Appeals on the first appeal sustaining the validity of the By-Law, which the petitioner did not seek to review, is in harmony, not in conflict, with the applicable New Jersey decisions.

A. The question presented by petitioner's reason 1 has been decided adversely to his contention by the highest court of New Jersey.

B. The question presented by petitioner's reason 2 has been decided adversely to his contention by the highest court of New Jersey.

V. Reasons 3 and 4 assigned by the petitioner involve familiar questions of corporate management which this court has repeatedly declined to review.

I.

The first mandate and decision of the Circuit Court of Appeals constituted a final determination of all the issues in the cause, and the time to apply for a writ of certiorari expired three months after June 29, 1932, the date of entry thereof.

By its mandate and decision, on the first appeal, the Circuit Court of Appeals disposed of every issue in the case.

The majority opinion of the Circuit Court of Appeals, after holding (R., p. 233) that Article XII "was properly passed and became a valid, governing act of the corporation." said (R., p. 234):

> "* * * That the president and five vice-presidents each received unusually large salaries as a result does not justify a court of equity in attempting to substitute its judgment for the judgment of the stockholders whose affair it is in the absence of any claim of fraud. In any case, we think that the by-law was lawfully passed and that it was valid, effective and controlling in the allotment of additional compensation to officers of the corporation."

The instruction to the District Court contained in the mandate of the Circuit Court of Appeals, "that such further proceedings be had in such cause in accordance with the decision of this court," was therefore a final mandate of the Circuit Court of Appeals directing the District Court to render judgment dismissing the complaints upon the merits. *Gulf Refining Co.* v. *United States*, 269 U. S. 125, 136.

No evidence could have been taken by the District Court or considered, no change in the issue was possible, nothing remained for the District Court, but the ministerial duty of entering the decree dismissing the complaints upon the merits. *Gulf Refining Co.* v. *United States*, 269 U. S. 125, 136; *McGourkey* v. *Toledo*, 146 U. S. 536; *Bostwick* v. *Brinkerhoff*, 106 U. S. 3.

The petitioner himself asserts in the assignment of errors that the decree of the District Court of July 8, 1932 was entered "solely upon the mandate and decision of the Circuit Court of Appeals" (R., p. 246).

The decree of July 8, 1932, of the District Court shows on its face (R., pp. 242-3) that that Court consulted and obeyed the mandate and decision of the Circuit Court of Ap-

peals and entered its decree dismissing the complaint on the merits in accordance therewith. In so doing, the District Court was correct. *Gulf Refining Co.* v. *United States*, 269 U. S. 125, 136; *Farmers' National Bank* v. *Wilkinson*, 266 U. S. 503; *Toledo Scale Co.* v. *Computing Scale Co.*, 261 U. S. 399; *Mutual Life Insurance Co.* v. *Hill*, 193 U. S. 551; *In re Sanford Fork and Tool Co.*, 160 U. S. 247, 255; *Roberts* v. *Cooper*, 20 How. 467.

The decision and mandate of the Circuit Court of Appeals thus being final, petitioner should have applied for a writ of certiorari to this Court within three months from the issuance of its mandate, to wit, three months from June 29, 1932. *Morton* v. *United States*, No. 638, October Term, 1932; *Dubilier Condenser Corporation* v. *Radio Corporation of America*, No. 396, October Term, 1932; *Gotham Can Co.* v. *United States*, 281 U. S. 706; *Hooper* v. *United States*, 274 U. S. 743; *Rust Land & Lumber Co.* v. *Jackson*, 250 U. S. 71, 76. This he did not choose to do, but appealed again to the Circuit Court of Appeals.

Petitioner erroneously says in his brief that "the first decision," that is, of the Circuit Court of Appeals, "merely reversed an interlocutory order and dissolved an injunction *pendente lite*, a discretionary matter" (Petitioner's Brief, p. 4). In truth, the first decision was on the merits, wherefore Judge AUGUSTUS N. HAND was constrained by it on the second appeal.

This contention that the decree of the Circuit Court of Appeals entered on the first appeal did not permit of an application for a writ of certiorari because it involved a matter of discretion is refuted by (1) the opinions of the Circuit Court of Appeals on both appeals and (2) the history of the cause.

If the first appeal involved a discretionary matter, the injunction *pendente lite* would not have been disturbed on

appeal. *Goldwyn Pictures Corp.* v. *Goldwyn*, 296 Fed. 391 (C. C. A. 2d); *Maison Dorin Societe Anonyme* v. *Arnold*, 296 Fed. 387 (C. C. A. 2d).

If petitioner had any doubt concerning the finality of the first decree of the Circuit Court of Appeals, that doubt should not be permitted to extend his right of review of that decree beyond the three months' period provided by the statute. Act of February 13, 1925, c. 229, Sect. 8(a), 43 Stat. 936, 940 (U. S. C., Title 28, Section 350). But he could have had no doubt whatever of the finality of the decree of the District Court dismissing the complaint on the merits and he knew, at the time of its entry, that that decree was based solely on the mandate and decision of the Circuit Court of Appeals.

II.

The application for a writ of certiorari from the second decree of the Circuit Court of Appeals presents no reviewable question.

The only question that could actually be presented to the Circuit Court of Appeals by that appeal was whether the decree of the District Court was in conformity with the mandate and opinion of the Circuit Court of Appeals on the first appeal. *Toledo Scale Co.* v. *Computing Scale Co.*, 261 U. S. 398, 418.

The errors assigned by petitioner (R., p. 246) attempted to bring up for consideration in the Circuit Court of Appeals the merits of the controversy which had already been decided by it. He did not assign as error that the decree of the District Court was not in conformity with the mandate and decision of the Circuit Court of Appeals but, on the contrary, assigned as error that the District Court erred in dismissing the bills of complaint solely upon the mandate and decision of the Circuit Court of Appeals.

Thus the appeal taken by petitioner, as disclosed by the assignment of errors, was an attempt to appeal from the Circuit Court of Appeals to itself. *Aspen Mining & Smelting Co.* v. *Billings,* 150 U. S. 31, 37; *Texas Pacific Railway Co.* v. *Anderson,* 149 U. S. 237, 242; *Mackall* v. *Richards,* 116 U. S. 45, 56; *Humphrey* v. *Baker,* 103 U. S. 736; *Stewart* v. *Salamon,* 97 U. S. 361.

The Circuit Court of Appeals affirmed, thus determining that the decree of the District Court was in conformity with its mandate and opinion on the previous appeal.

It is evident that no ground appears upon which this Court should review the mandate and decision of the Circuit Court of Appeals entered upon the second appeal.

III.

No special or important reasons are shown for the exercise by this Court of its discretionary powers of review.

The validity of By-Law XII is a question of New Jersey law decided by the Circuit Court of Appeals in harmony with the New Jersey decisions, as is shown under the next point.

The alternative prayer for relief that, in the event that the By-Law be adjudged valid, the Court "fix the fair and reasonable compensation" of the officers of the Company (R., p. 21), presents the familiar question of internal corporate management.

Acting fairly, in the interests of all, the stockholders have the right to decide whether their By-Law shall be continued, revised or repealed; indeed they expressly reserved that right to themselves in the By-Law itself (R., p. 25). It is for them to measure its results and to determine whether the benefits to the entire body of stockholders justify its con-

tinuance. It is for the stockholders to determine the reasons for the Company's success, resulting in large profits to themselves and in correspondingly large contingent compensation to the officers. If they believe the relation of cause and effect exists between their profits and such contingent compensation, it is for them to decide whether they want to hazard a continuance of their own profits on a change of policy.

There is not a single suggestion in the bill of complaint of oppression of a minority by a majority interest or of any element of fraud, either actual or constructive.

The complaint does not allege even that the payments under the By-Law are by themselves excessive, but only that they become excessive when added to other payments (R., p. 20).

But this case involves only the payments made under the corporate law, adopted by almost a unanimous vote of stockholders, and constituting a part of the contract of employment.

If other payments or stock allotments have been wrongful, the remedy is a proper suit or suits to redress those wrongs and the petitioner says in his bill, and this Court knows, that he is pursuing those remedies (R., pp. 14, 15).

IV.

The decision of the Circuit Court of Appeals on the first appeal, sustaining the validity of the By-law, which the petitioner did not seek to review, is in harmony, not in conflict, with the applicable New Jersey decisions.

A. *The question presented by petitioner's reason 1 has been decided adversely to his contention by the highest court of New Jersey.*

The question as to whether compensation to executives of a New Jersey corporation can be based upon a contingent share of its profits is a matter of local law which has been decided by the highest court of New Jersey in *Bennett* v. *Millville Improvement Co.*, 67 N. J. L. 320, and thereafter reaffirmed by subsequent decisions by the courts of that State.

The Company was organized in 1904. Article XII was adopted in 1912. It provided expressly that the amount to be paid to the six chief executive officers under the provisions thereof was to be paid "as salary for the year, in addition to the fixed salary of each of said officers."

By Article II of the Charter of the Company the latter was given the powers conferred by Section 1 of the New Jersey Act Concerning Corporations (Revision of 1896) (R., p. 28).

Section 1 of the General Corporation Act of New Jersey provides, among other things:

> "Every corporation shall have power:
>
> * * * * * * * *
>
> V. To appoint such officers and agents as the business of the corporation shall require, and to allow them suitable compensation."

The participation in the share of the profits authorized by Article XII of the By-Laws was expressly designated as additional salary, was allowed by the stockholders, and comes within the express powers delegated to the Company by the General Corporation Act of New Jersey.

The compensation to officers, as to any other agent, is an operating expenditure of the Company. It makes no difference whether the compensation is in the form of a fixed salary or based upon the profits of the Company. Until the expenditures have been met, there are no net profits of the Company.

The precise question here presented has already been decided by the Court of Errors and Appeals of New Jersey in *Bennett* v. *Millville Improvement Co.*, 67 N. J. L. 320 (1902).

There, plaintiff, employed to construct a glass works for the defendant, and, after its construction, to manage its operations, was to be paid a fixed compensation and one-sixth of the net profits of the company's business. He brought suit for the one-sixth and defendant there relied upon § 47 of the General Corporation Act of New Jersey (L. 1901, Ch. 110, § 2), which provides that:

> "Unless otherwise provided in the original or amended certificate of incorporation, or in a by-law adopted by a vote of at least a majority of the stockholders, the directors of every corporation * * * shall, in January in each year, after reserving over and above its capital stock paid in, as a working capital for said corporation, such sum, if any, as shall have been fixed by the stockholders, declare a dividend among its stockholders of the whole of its accumulated profits exceeding the amounts so reserved, and pay the same to such stockholders on demand."

This contention of defendant, which is the same contention as petitioner raises here, was swept aside by the Court, which said (p. 323):

> "* * * But this one-sixth proposed to be given to the plaintiff was salary—payment for services—and not part of the profits, but part of the expenses of the business, and if the corporation had permitted its president, by acquiescence or by receiving the benefit of the services for which this one-sixth was to pay, to make this arrangement, then the corporation was as much bound to pay this as to pay the fixed salary which they had agreed to. The profits referred to in Section 47 were not ascertained until this expense of conducting the business had been paid."

The right to pay compensation by way of participation in the net profits was recognized and reaffirmed subsequently in New Jersey by the following cases: *Smith* v. *Bedell Bros.*, 84 N. J. Eq. 268, affd. 84 N. J. Eq. 509; *Booth* v. *Beattie*, 95 N. J. Eq. 776, affd. 95 N. J. Eq. 776; *Costello* v. *Thomas Cusack Co.*, 96 N. J. Eq. 95.

The right to pay the agents of a corporation by a participation in the net profits has been recognized by all courts to which the question has been presented. *Harker* v. *Ralston Purina Co.*, 45 Fed. (2d) 929, certiorari denied, 284 U. S. 619; *Church* v. *Harnit*, 35 Fed. (2d) 499, certiorari denied, 281 U. S. 732; *Young* v. *U. S. Mortgage & Trust Co.*, 214 N. Y. 279; *Neff* v. *Gas & Electric Shop*, 232 Ky. 66; *Zwolanek* v. *Baker Mfg. Co.*, 150 Wisc. 517; *Putnam* v. *Juvenile Shoe Corp.*, 307 Mo. 74; *Ransome Concrete Machinery Co.* v. *Moody*, 282 Fed. 29; *Matter of Rosenberg*, 213 N. Y. App. Div. 167, 169.

B. *The question presented by petitioner's reason 2 has been decided adversely to his contention by the highest court of New Jersey.*

Because the Charter of the Company provides that, "the power to make and alter by-laws of said merged corporation is conferred upon the directors," petitioner asserts that the stockholders of the Company had no power to adopt Article XII.

That contention is conclusively answered by Section 11 of the General Corporation Act of New Jersey (Revision 1896, L. 1896, Ch. 185, § 11), which provides:

> "The power to make and alter by-laws shall be in the stockholders, but any corporation may, in the certificate of incorporation, confer that power upon the directors; by-laws made by the directors under power so conferred may be altered or repealed by stockholders."

As stated in *In re Griffing Iron Co.*, 63 N. J. L. 168; affd. on opinion below, 63 N. J. L. 357 (p. 171):

> "* * * That the stockholders had delegated to the directors power to amend the by-laws did not curtail their own power to amend them, and of course the later statute (revision of 1896) removed all possible restriction on such power."

The right to alter and amend the by-laws includes the power to add as well as to change or eliminate. In *In re Griffing Iron Co.*, 63 N. J. L. 168, the Court said (p. 172):

> "* * * Our statute authorizes action by the stockholders under by-laws subject to alteration. Special meetings of the stockholders may be held under the by-laws, or, in case of necessity, under the statute. Sections 1, 2, 17, 46."

The power to amend the Constitution of the United States includes the power to make additions thereto, such as the Eighteenth Amendment. *Rhode Island* v. *Palmer*, 253 U. S. 350; *Christian Feigenspan, Inc.* v. *Bodine*, 264 Fed. 186, 190, affd. 253 U. S. 350.

In *Scott* v. *P. Lorillard Co.*, 108 N. J. Eq. 153, 155; affd. 109 N. J. Eq. 417, cited by petitioner, the Court held expressly that the authority to fix compensation for the directors of a corporation lay with the stockholders. In *Lillard* v. *Oil, Paint and Drug Co.*, 70 N. J. Eq. 197, 206 the Court pointed out that if the stockholders had no such power, the corporation might not be able to employ any director as an agent against the objection of any stockholder.

No New Jersey case is cited justifying petitioner's position. The cases cited by him from jurisdictions other than New Jersey rest upon specific statutes and are, as pointed out by the very authors cited by petitioner, an exception to the general rule that the power to make by-laws vests exclusively in stockholders.

So far as the B stockholders are concerned, they became such by virtue of the fact that they were originally holders of Common Stock of the Company, and as such are bound by Article XII. *Baumohl* v. *Goldstein,* 95 N. J. Eq. 597; *Kavanaugh* v. *Commonwealth Trust Co.,* 223 N. Y. 103, 107; *Richardson* v. *Devine,* 193 Mass. 336.

Moreover, the action of the stockholders on March 13, 1912 would be valid as a resolution fixing the compensation of the Company's officers, binding upon the Company, irrespective of whether it be called a by-law.

V.

Reasons 3 and 4 assigned by the petitioner involve familiar questions of corporate management which this Court has repeatedly declined to review.

Harker v. *Ralston Purina Co.,* 45 Fed. (2d) 929, *certiorari* denied, 284 U. S. 619;
Church v. *Harnit,* 35 Fed. (2d) 499, *certiorari* denied, 281 U. S. 732.

Petitioner points to no case and there is none, which holds that the stockholders of a New Jersey corporation have not the right to fix the compensation of its agents who are directors. Indeed, as already shown, the cases are to the contrary.

When the By-Law was passed, the stockholders had in mind that the greater the profits of the Company the greater the compensation to the officers. This additional salary was purely and wholly contingent. That there were these profits was due to the efficiency of the Company's executives. The question, therefore, whether the officers have been too successful and their compensation under the By-Law too great is for the stockholders, who have been benefited, and not for

a court, to determine. The By-Law itself so provides, as it states that this By-Law can only be repealed or amended by the stockholders.

Petitioner, in *Rogers* v. *Guaranty Trust Co., et al.*, 53 Sup. Ct. 295, asserted that the directors had no right to fix their own compensation, and in this cause he asserts that the stockholders had no right to fix the compensation of the directors who were employes. *If the directors cannot fix their compensation as officers, with the approval of the stockholders, and the stockholders cannot fix such compensation, then who has the power?*

The petitioner's statements in his brief, in respect of other payments and stock allotments, the subject of other suits (R., pp. 14, 15), merely serve to confuse the issues of this case, which concern only the validity of the By-Law and the payments thereunder. The validity of such payments are not affected by other payments, which may or may not be valid, but whose validity is the subject of other suits and is not even challenged in this suit.

Petitioner has adopted the device of bringing three separate causes each affecting a different element of compensation, to wit:

> (1) The validity of the Stock Plan. (*Rogers* v. *Guaranty Trust Co., et al.*, 53 Sup. Ct. 295; now the subject of a suit in the State Court of New Jersey.)
>
> (2) The validity of compensation under the By-Law. (This cause.)
>
> (3) The payments made for compensation through stock plans in prior years. (Subject of suit in New York State Court.)

Petitioner, without directly charging, intimates that the complaint proceeds upon the theory of fraud. He makes no such charge in his bill of complaint, and in both of the lower courts he disclaimed that he was proceeding upon fraud and

asserted that his attack upon the By-Law was based entirely on the claim of illegality, as indeed it is.

So far as the cases relied upon by petitioner are concerned, they stand for the proposition that where the majority stockholders have acted, a minority stockholder has no cause for complaint (*Church* v. *Harnit,* 35 Fed. [2d] 499, certiorari denied, 281 U. S. 732; *Ransome Concrete Machinery Co.* v. *Moody,* 282 Fed. 29; *Putnam* v. *Juvenile Shoe Corp.,* 307 Mo. 74), or they involve situations where:

(1) the stockholders were receiving no returns from the corporation; *Raynolds* v. *Diamond Mills Co.,* 69 N. J. Eq. 299, 312; *McMahon* v. *Burdette,* 106 N. J. Eq. 79, 80;

(2) the directors voted compensation to themselves after the services were completed; *Schall* v. *Althaus,* 208 N. Y. App. Div. 103, 106;

(3) the stockholders had no voice in fixing the compensation; *Mitchell* v. *United Box Board & Paper Co.,* 72 N. J. Eq. 580, 585; *Gardner* v. *Butler,* 30 N. J. Eq. 702; *Stratis* v. *Andreson,* 254 Mass. 536; *Nichols* v. *Olympia Veneer Co.,* 139 Wash. 305; *Sotter* v. *Coatesville Boiler Works,* 257 Pa. 411; *Collins* v. *Hite,* 109 W. Va. 79; *Lowman* v. *Harvey R. Pierce Co.,* 276 Pa. 382;

(4) the compensation voted was in the nature of dividends to the exclusion of other stockholders; *Godley* v. *Crandall,* 153 N. Y. App. Div. 697, 710; *Scott* v. *P. Lorillard Co.,* 108 N. J. Eq. 153, aff'd 109 N. J. Eq. 417;

(5) the directors were the majority stockholders; *Lillard* v. *Oil Co.,* 70 N. J. Eq. 197, 204; *Wight* v. *Heublein,* 238 Fed. 321; *Atwater* v. *Elkhorn Co.,* 184 N. Y. App. Div. 253, 258; *McKey* v. *Swenson,* 232 Mich. 505; *Decatur Land Co.* v. *Palm,* 113 Ala. 531, 537; *Backus* v. *Finkelstein,* 23 Fed. (2d) 531, 537.

Not one of the controlling reasons for the decision in any of the foregoing cases exists in this case. In none of the cases relied upon by petitioner was there a contract, between the corporation and the officer, authorized in the first instance by the stockholders as to the rate and amount of the compensation.

Conclusion.

The reasons advanced by petitioner for the granting of a writ of certiorari present no issue as to which this Court should exercise its discretionary power of review. The facts set forth are wholly individual and unique. No question of Federal jurisdiction or of general interest is presented, nor is there any conflict of decisions to be resolved.

The petition should be denied.

Respectfully submitted,

NATHAN L. MILLER,
WILLIAM M. PARKE,
Counsel for Respondents.

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MAY 4

Supreme Court of the United States

OCTOBER TERM, 1932

No. 732

RICHARD REID ROGERS,
Petitioner,
against
GEORGE W. HILL, C. F. NEILEY, V. RIGGIO AND THE AMERICAN TOBACCO COMPANY,
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and
A. C. MOWER AND CHARLES A. PENN (deceased),
Defendants.

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against
THOMAS R. TAYLOR AND THE AMERICAN TOBACCO COMPANY,
Respondents.

Consolidated Cause.

BRIEF ON BEHALF OF RESPONDENTS

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CORPORATE PRESS, INC., NEW YORK CITY

SUBJECT INDEX

PAGE

PRELIMINARY STATEMENT 1

Origin of Article XII 2

Results Achieved Under Article XII 4

The Theory of the Complaint 6

The Answer 6

Summary of Argument 10

ARGUMENT 11

I. The Scope of the Review 11

No question was raised by plaintiff's appeal to the Circuit Court of Appeals from the decree of the District Court entered July 8, 1932, other than whether that decree complied with the mandate and decision of the Circuit Court of Appeals of June 29, 1932. The decree of the Circuit Court of Appeals on plaintiff's appeal, to review which the present writ of certiorari has been granted, presents the single question whether the Circuit Court of Appeals correctly interpreted its previous mandate and decision 11

II. The action involves an interference with the internal management of a New Jersey corporation, and as a necessary feature thereof, the construction and interrelation of many New Jersey Statutes, as to which the courts of the corporate domicile afford the proper forum 14

III. Plaintiff has failed to comply with Equity Rule 27 20

PAGE

IV. Article XII is legal, *intra vires*, and valid 24

(1) There is nothing in the charter that prohibits the payment to the officers or other employes of the Company of compensation measured by its profits 24

(2) Under the General Corporation Act of New Jersey (revision of 1896), the stockholders have always had the power to pay officers contingent additional salary measured by the net profits of the corporation 27

A. Article XII, duly adopted by the shareholders, created a contract with the officers which is unassailable as to all compensation earned 31

B. The complaint does not charge any fraud 32

C. Cases cited by plaintiff have no application 37

(3) The stockholders of a New Jersey corporation have complete power over its by-laws .. 38

V. Other payments or benefits under later plans which are the subjects of other suits are wholly irrelevant in this suit 44

VI. The Court will not substitute its judgment for that of the stockholders and no facts are pleaded justifying interference with the internal management of the Company 45

VII. Laches 53

VIII. Conclusion 56

Appendix A 59

Table of Cases Cited

PAGE

Aspen Mining & Smelting Co. v. Billings, 150 U. S. 31, 37 ... 12
Atlantic Life Ins. Co. v. Rowland, 22 Fed. (2d) 126 ... 54
Atwater v. Elkhorn Valley Coal-Land Co., 184 N. Y. App. Div. 253, 258 ... 51
Backus-Brooks Co. v. Northern Pac. Ry. Co., 21 Fed. (2d) 4 ... 54
Backus v. Finkelstein, 23 Fed. (2d) 531, 537 ... 51
Bagley v. Carthage, W. & S. H. R. R. Co., 165 N. Y. 179 ... 32
Baumohl v. Goldstein, 95 N. J. Eq. 597 ... 42
Bennett v. Millville Improvement Co., 67 N. J. L. 320 ... 26, 27, 29, 30, 37
Bisbee v. Midland Linseed Products Co., 19 Fed. (2d) 24 ... 51
Black v. Delaware & Raritan Canal Co., 24 N. J. Eq. 455 ... 38
Booth v. Beattie, 95 N. J. Eq. 776, affd. 95 N. J. Eq. 776 ... 26, 29, 31, 51
Bostwick v. Brinkerhoff, 106 U. S. 3 ... 12
Brictson Mfg. Co. v. Close, 280 Fed. 297 ... 51
Canada Malting Co., Ltd. v. Paterson Steamships, Ltd., 285 U. S. 413 ... 14
Central Transportation Co. v. Pullman's Car Co., 139 U. S. 24, 28 ... 37
Chandler v. Monmouth Bank, 13 N. J. L. 255 ... 32
Christian Feigenspan, Inc. v. Bodine, 264 Fed. 186, 190; affd. 253 U. S. 350 ... 40
Church v. Harnit, 35 Fed. (2d) 499, certiorari denied, 281 U. S. 732 ... 29, 49
Colgate v. U. S. Leather Co., 75 N. J. Eq. 229 ... 38
Collins v. Hite, 109 W. Va. 79 ... 51
Collins v. Penn-Wyoming Copper Co., 203 Fed. 726 ... 54
Consolidated Cement Corp. v. Pratt, 47 Fed. (2d) 90 ... 51
Corinne Mill, Canal & Stock Co. v. Toponce, 152 U. S. 405 ... 32
Costello v. Thomas Cusack Co., 96 N. J. Eq. 95 ... 29
Crawford v. Lees, 84 N. J. Eq. 324 ... 55
Cuba Railroad Co. v. Crosby, 222 U. S. 473 ... 14

PAGE

Dalsheimer v. Graphic Arts Co., 86 N. J. Eq. 49; affd. 89 N. J. Eq. 210 55
Dana v. The American Tobacco Co., 72 N. J. Eq. 44; affd. 73 N. J. Eq. 736 55
Decatur Mineral & Land Co. v. Palm, 113 Ala. 531, 537 51
Dubilier Condenser Corporation v. Radio Corporation of America, No. 396, October Term, 1932 13
DuPont v. DuPont, 256 Fed. 129, certiorari denied, 250 U. S. 642 51

Edwards v. Mercantile Trust Co., 124 Fed. 381 54
Eiffert v. Craps, 58 Fed. 470 54
Einstein v. Raritan Woolen Mills, 74 N. J. Eq. 624 38
Elevator Supplies Co. v. Wylde, 106 N. J. Eq. 163 51
Endicott v. Marvel, 81 N. J. Eq. 378; affd. 83 N. J. Eq. 632 ..... 31, 55
Ernst v. Rutherford, 38 App. Div. 388 20
Eyster v. Centennial Board of Finance, 94 U. S. 500, 503 29

Farmers Loan & Trust Co. v. Hewitt, 94 N. J. Eq. 65 52
Farmers National Bank v. Wilkinson, 266 U. S. 503 .. 12
First National Bank of Lyndhurst v. Bianchi & Smith, 106 N. J. Eq. 333 19
Fitzgerald and Mallory Construction Co. v. Fitzgerald, 137 U. S. 98 32
Fox v. Arctic Placer Mining & Milling Co., 229 N. Y. 124 32

Galliher v. Cadwell, 145 U. S. 368 54
Gardner v. Butler, 30 N. J. Eq. 702 50
General Investment Co. v. American Hide & Leather Co., 97 N. J. Eq. 214 51
Ginter v. Heco Envelope Company, 316 Ill. 183 31
Glenn v. Liggett, 135 U. S. 533 ..... 17, 18
Godley v. Crandall & Godley Co., 153 N. Y. App. Div. 697, 710 51
Goodbody v. Delaney, 80 N. J. Eq. 417 18
Gotham Can Co. v. United States, 281 U. S. 706 13

In Re Gouverneur Pub. Co., 168 Fed. 113 32
In Re Griffing Iron Co., 63 N. J. L. 168; affd. 63 N. J. L. 357 ..... 39, 41

PAGE

Gulf Refining Co. v. United States, 269 U. S. 125, 136 .. 12

Hamilton v. United Laundries Corp., 111 N. J. Eq. 78 20
Hardt v. Heidweyer, 152 U. S. 547 54
Harker v. Ralston Purina Co., 45 Fed. (2d) 929, certiorari denied, 284 U. S. 619 29
Harrison v. London Assurance Corp., 10 App. Cas. 438, 450 29
Haynes & Co. v. Druggists' Circular, 32 Fed. (2d) 215 54
Hecht v. Malley, 265 U. S. 144, 153 30
Heine v. New York Life Insurance Co., 50 Fed. (2d) 382 14
Heinz v. National Bank of Commerce, 237 Fed. 942 .. 51
Hooper v. United States, 274 U. S. 743 13
Humphrey v. Baker, 103 U. S. 736 12

Jackson v. Hooper, 76 N. J. Eq. 592 ..... 15, 20
Jacobson v. Brooklyn Lumber Co., 184 N. Y. 152 52
Jesup v. Illinois Cent. R. Co., 43 Fed. 483 54

Kavanaugh v. Commonwealth Trust Co., 223 N. Y. 103, 107 42
Kean v. Johnson, 9 N. J. Eq. 401 38
Kelly v. Kelly-Springfield Tire Co., 106 N. J. Eq. 545 .. 51
Kessler v. Ensley Co., 123 Fed. 546 54
Kimball v. St. Louis & San Francisco Railroad Co., 157 Mass. 7 19

Langnes v. Green, 282 U. S. 531 ..... 14, 17
Lazear v. American Steel Foundries, 86 N. J. Eq. 21 .. 55
Liberty Warehouse Co. v. Grannis, 273 U. S. 70 16
Lillard v. Oil, Paint and Drug Co., 70 N. J. Eq. 197, 206 ..... 42, 43, 51
Lowenthal v. Rubber Reclaiming Co., 52 N. J. Eq. 440 38
Lowman v. Harvey R. Pierce Co., 276 Pa. 382 51

Mackall v. Richards, 116 U. S. 45 12
Madsen v. Burns Bros., 108 N. J. Eq. 275 51
Manufacturers Exhibition Bldg. Co. v. Landay, 219 Ill. 168 40
Marks v. Merrill Paper Co., 203 Fed. 16 54
Mayer v. Oxidation Products Co., Inc., 110 N. J. Eq. 141 20
McDermott v. Woodhouse, 87 N. J. Eq. 615 17

PAGE

McGourkey v. Toledo & Ohio Railway, 146 U. S. 536 ... 12
McKey v. Swenson, 232 Mich. 505 51
McMahon v. Burdette, 106 N. J. Eq. 79, 80 51
Metropolitan Rubber Co. v. Place, 147 Fed. 90 31
Mills v. Central R. R., 41 N. J. Eq. 1 38
Mitchell v. United Box Board & Paper Co., 72 N. J. Eq. 580 50
Modern Woodmen of America v. Mixer, 267 U. S. 544 .. 18
Montana Tonapah Mining Co. v. Dunlap, 196 Fed. 612 32
Moore v. Silver Valley Mining Co., 104 N. C. 534 19
Morton v. United States, No. 638, October Term, 1932 . 13
Mutual Life Insurance Co. v. Hill, 193 U. S. 551 12

Neff v. Gas & Electric Shop., 232 Ky. 66 29
In re Newark Library Assn., 64 N. J. L. 217 38
Nichols v. Olympia Veneer Co., 139 Wash. 305 51

O'Connor v. International Silver Co., 68 N. J. Eq. 67 . 23

Park v. Grant Locomotive Works, 40 N. J. Eq. 114 37
Putnam v. Juvenile Shoe Corp., 307 Mo. 74 .... 29, 49, 52

Rabe v. Dunlap, 51 N. J. Eq. 40 55
Ransome Concrete Machinery Co. v. Moody, 282 Fed. 29 ..... 30, 49
Raynolds v. Diamond Mills Paper Co., 69 N. J. Eq. 299 50
Rhode Island v. Palmer, 253 U. S. 350 40
Richardson v. Devine, 193 Mass. 336 42
Riker & Son Co. v. United Drug Co., 79 N. J. Eq. 589 .. 38
Roberts v. Cooper, 20 How. 467 12
Robinson v. Benbow, 298 Fed. 561 51
Rogers v. Guaranty Trust Co., et al., 53 Sup. Ct. Rep. 295 ..... 14, 15, 16, 17, 29, 43
Matter of Rosenberg, 213 N. Y. App. Div. 167, 169 30
Rust Land & Lumber Co. v. Jackson, 250 U. S. 71 13
In Re Sanford Fork and Tool Co., 160 U. S. 247 12

Schall v. Althaus, 208 N. Y. App. Div. 103, 106 50
Schuler v. Southern Iron & Steel Co., 77 N. J. Eq. 60 .. 55
Scott v. P. Lorillard Co., 108 N. J. Eq. 153; affd. 109 N. J. Eq. 417 ..... 42, 51
Seitz v. Union Brass & Metal Mfg. Co., et al., 152 Minn. 460 52

PAGE

Smith v. Bedell Bros., 84 N. J. Eq. 268; affd. 84 N. J. Eq. 509 ..... 29, 31
Sotter v. Coatesville Boiler Works, 257 Pa. 411 51
Spiller v. St. Louis & S. F. R. Co., 14 Fed. (2d) 284 .. 54
Squair v. Lookout Mountain Co., 42 Fed. 729 23
State v. Shaw, 103 Ohio St. 660 43
Stewart v. Salamon, 97 U. S. 361 12
Stone, et al. v. Holly Hill Fruit Products, Inc., 56 Fed. (2d) 553 22
Storrs v. James Butler Grocery Co., 96 N. J. Eq. 359 .. 51
Stratis v. Andreson, 254 Mass. 536 51

Texas & Pacific Railway Co. v. Anderson, 149 U. S. 237 12
Toledo Scale Co. v. Computing Scale Co., 261 U. S. 399 ..... 12, 13

United Copper Co. v. Amalgamated Copper Co., 244 U. S. 261 22
United States v. American Tobacco Company, 221 U. S. 106 2
United States v. American Tobacco Company, 191 Fed. 371 2
United States Steel Corporation v. Hodge, 64 N. J. Eq. 807 ..... 23, 31, 36

Wathen v. Jackson Oil Co., 235 U. S. 635 22
Wellington Bull & Co., Inc. v. Morris, 132 Misc. 509; affd. 226 App. Div. 868 ..... 32, 52
Weniger v. Success Mining Co., 227 Fed. 548 54
Wight v. Heublein, 238 Fed. 321 51
Willing v. Chicago Auditorium, 277 U. S. 274 16
Willoughby v. Chicago Junction Railway, etc., Co., 50 N. J. Eq. 656 18
Windhurst v. Central Leather Co., 101 N. J. Eq. 543 .. 55
Window Glass Mach. Co. v. Pittsburgh Plate Glass Co., 46 Fed. (2d) 484 53

Young v. U. S. Mortgage & Trust Co., 214 N. Y. 279 .. 29

Zabriskie v. Hackensack & N. Y. R. R. Co., 18 N. J. Eq. 178 38
Zwolanek v. Baker Mfg. Co., 150 Wis. 517 ..... 29, 31, 32

Table of Statutes Cited

PAGE

NEW JERSEY:

General Corporation Act, § 1 (P. L. 1896, ch. 185, § 1) 10, 24, 27, 39, 41
General Corporation Act, § 11 (L. 1896, ch. 185, § 11) 14, 38, 39
General Corporation Act, § 17 (L. 1896, ch. 185, § 17, am'd L. 1901, ch. 119, § 1) 15
General Corporation Act, § 27 (L. 1896, ch. 185, § 27, as am'd L. 1908, ch. 84, § 1) 15
General Corporation Act, § 46 (L. 1896, ch. 185, § 46) 21, 22
General Corporation Act, § 47 (L. 1901, ch. 110, § 2) 28, 29
General Corporation Act, § 158 (L. 1920, ch. 175, § 1(b)) 6
General Corporation Act, § 158(c) (L. 1920, ch. 175, § 4, as amended L. 1932, ch. 192) 30
General Corporation Act, § 158-158(c) (L. 1920, ch. 175, §§ 1-4) 24, 27, 30
Act of 1932, ch. 192 amending ch. 175, L. 1920 ... 15, 30
New Jersey Constitution, Article VI, Sec. I 27

UNITED STATES:

Act of Feb. 13, 1925, c. 229, § 8(a), 43 Stat. 936-940 (U. S. C., Title 28, § 350) 12

SUPREME COURT REVISED RULES:

Rule 38 (275 U. S. 579, 622, as am'd 286 U. S. 622 52 Sup. Ct. XV) 14

FEDERAL EQUITY RULES OF PRACTICE:

Rule 27 (226 U. S. 656) 6, 10, 20, 22, 23, 24

Other Authorities Cited

Fletcher Cyclopedia Corporation (Permanent Edition) Vol. 8, § 4172 41
Thompson on Corporation (3d Ed.) Vol. 2, § 1018 41
Berle and Means—The Modern Corporation and Private Property 47

Supreme Court of the United States

OCTOBER TERM, 1932

No. 732

RICHARD REID ROGERS,
Petitioner,
against
GEORGE W. HILL, C. F. NEILEY, V. RIGGIO and THE AMERICAN TOBACCO COMPANY,
Respondents,
and
A. C. MOWER and CHARLES A. PENN (deceased),
Defendants.

CONSOLIDATED CAUSE

RICHARD REID ROGERS,
Petitioner,
against
THOMAS R. TAYLOR and THE AMERICAN TOBACCO COMPANY,
Respondents.

BRIEF ON BEHALF OF RESPONDENTS

Preliminary Statement.

Plaintiff,* who became a stockholder of The American Tobacco Company, a New Jersey Corporation (hereinafter called the "Company") in 1917 and who owns 200 shares of its Common Stock and 400 shares of its Common Stock B,

* We shall designate petitioner as plaintiff and the individual respondents as defendants.

attacks the validity of a By-Law known as Article XII adopted by the Company's stockholders on March 13, 1912 (R., p. 49).

Plaintiff seeks to have Article XII declared invalid and also to have all compensation paid to the individual defendants thereunder—in some instances from as early as 1921—repaid to the Company (R., p. 13) and the Company enjoined from thereafter paying to the defendants or their successors in office "any consideration in whatsoever form" over a sum to be fixed by the Court (R., p. 13).

Origin of Article XII.

Pursuant to the mandate of this Court, in *United States* v. *American Tobacco Company*, 221 U. S. 106, the United States District Court for the Southern District of New York, on November 15, 1911, entered a decree providing for the practical disintegration of The American Tobacco Company as then constituted.

The division of its domestic business, assets and plants and the allocation of important brands of cigarettes, cigars, smoking tobacco, etc., was then made among four companies, to wit, the defendant Company, Liggett & Myers Tobacco Company (a newly formed company), P. Lorillard Company (a newly formed company), and the R. J. Reynolds Tobacco Company (R., p. 54). The latter, the present manufacturer of Camel cigarettes, had not been engaged prior to 1912 in the cigarette business (R., p. 55). Decree of dissolution, *United States* v. *American Tobacco Company*, 191 Fed. 371.

Thus the Company was greatly reduced in importance in the tobacco industry and was also forced into immediate competition with corporations equally as strong in financial position, physical assets and prestige (R., pp. 54-55).

To insure to the Company the maintenance of the percentage of the business allocated to it under the dissolution

decree, the Company's stockholders recognized quickly the need of devising a method to encourage its executive personnel to use their greatest efforts. For the purpose of creating such an incentive, they adopted Article XII.

It was authorized by the practically unanimous vote of all stockholders present at the meeting at which it was adopted; only 35 shares of Preferred Stock and no Common Stock voted against it (R., p. 49).

Article XII* provides for payment, as salary additional to their fixed salaries (R., p. 14), to the President of 2½%, and to each of the five Vice-Presidents of 1½%, of a sum measured by the net earnings in excess of $11,369,000** made by the Company in its business as a manufacturer and seller of tobacco and its products (excluding the profits from certain subsidiary branches) after deducting all expenses and losses and after making such provisions for depreciation and all outstanding trade obligations as shall be determined by the board of directors (R., p. 15).

Thus the profits from such an important subsidiary as the American Cigar Company are, under the terms of that By-Law, excluded in computing this compensation (R., p. 89).

All of the individual defendants assumed their present offices many years after the adoption of Article XII (R., p. 8). It was a part of their contract of employment (R., p. 53). They rendered their services in reliance upon its terms (R., p. 53). They had no hand in its creation or adoption. They are not now and never have been majority stockholders in control of the Company (R., p. 50).

---

* Article XII is set forth in full in Appendix A, *infra*, pp. 58-59.

** Plaintiff's statement in his brief (p. 1) that the base is $8,222,245.82 is contrary to the fact. The By-Law, by § 3, provides that the 6% dividends on $52,459,400 of the Preferred Stock shall be deducted from the earnings before the net profits can be ascertained (R., p. 15). This latter amount added to the $8,222,245.82 makes the total base $11,369,000.

Results Achieved Under Article XII.

In no industry is competition more keen than in the cigarette business. The competitors of the Company are alert, ingenious and powerful (R., p. 67). The process of manufacturing, packing, selling and delivering daily more than 150,000,000 cigarettes is a task requiring a stupendous organization of human effort and constant vigilance, so as to maintain the standard of the product at its high degree of excellence (R., p. 66).

Upon this vast daily turnover the Company makes but a fraction of a cent per article. A hundredth of a cent variation in cost may make the difference in a loss or profit upon each item (R., p. 66), with the consequence that this slight variation can change an annual profit into a deficit.

In 1920 the Common Stock B was authorized by an amendment to the charter, and every common stockholder received a 75% stock dividend in the form of that newly authorized stock (R., p. 21). Both Common and Common Stock B then had a par value of $100 per share (R., p. 21). They have since been divided from time to time, so that the Common Stock and Common Stock B now have a par value of $25 per share.

As a result of such divisions and stock dividends, each stockholder of the Company owning stock in 1917 (providing he did not dispose of any of his stock) had by 1930, seven shares of Common and Common Stock B of the par value of $25 each instead of one share of Common Stock of the par value of $100 (R., p. 21). For each share of stock of $100 par value owned in 1917, each such stockholder, including plaintiff, was in 1931 receiving $42 in annual cash dividends.

The cash dividends paid to the Preferred, Common, and Common B stockholders between 1915 and 1923 exceeded $125,000,000 (R., p. 84-A). The cash dividends paid to all stockholders from 1924 to 1930, inclusive, were $147,000,000

(R., p. 84). In 1931 the cash dividends paid on all classes of stock were over $31,000,000 (R., p. 57).

Accordingly the grand total of the cash dividends paid by the Company from 1915 to 1931 exceeded $300,000,000 (R., pp. 84-84A).

The net earnings of the Company—after payment of taxes which in some years were as high as $150,000,000—for that period reached the stupendous sum of $356,000,000 (R., pp. 84-86A). This prosperity of the Company was not caused merely by any general condition in the tobacco industry, because the Company's sales were increasing while those of its competitors were decreasing.

Thus in 1930 the total increase over 1929 in cigarettes of all kinds sold in this country was approximately 500,000,000 whereas the increase in the sale of Lucky Strike cigarettes (the Company's product) was over 6,000,000,000* (R., p. 67).

Therefore, the Company's increase was, at the expense of its competitors, to the extent of 5,500,000,000 cigarettes. In the first ten months of 1931 the Company's sales of Lucky Strike cigarettes in the United States increased by 2,395,000,000 over the corresponding period of 1930, whereas the sales of its competitors' cigarettes decreased in that period by 4,479,000,000 (R., pp. 67-68).

The stockholders of the Company certainly have the right to believe that the remarkable success of the Company and the extraordinary return which they have received and are continuing to receive on their investment have justified their judgment in adopting Article XII.

---

* The Company sold approximately 37,000,000,000 of its Lucky Strike cigarettes in the United States in 1929, 43,000,212,000 in 1930 (R., p. 65), and a greater number in 1931 (R., p. 68). It sold in excess of 700,000,000 of its Cremo Cigars in 1930 (R., p. 65).

The Theory of the Complaint.

The complaint alleges and plaintiff contends here, that Article XII is illegal, *ultra vires,* and void for the following reasons:

(1) By the Charter of the Company (Exh. C, annexed to Complt.), the Directors are empowered to apply surplus or net profits only to the acquisition of property or to the payment of dividends, and are not authorized to divert a portion of the profits to officers by way of profit participation (R., p. 10);

(2) Profit participation by officers and employes of a New Jersey corporation was not legal prior to the passage of Chapter 175 of the Public Laws of 1920, subsection (b) of Section 1 (R., pp. 10-11);

(3) By the Charter, the power to make and alter By-Laws was conferred on the Directors, and the stockholders had no power to adopt Article XII (R., p. 11).

The complaint does not charge fraud, actual, constructive or otherwise. Indeed, plaintiff disclaimed in the court below that he was proceeding upon fraud, but asserted that his attack on the By-Law was based entirely upon a claim of illegality. Plaintiff, in this Court, for the first time intimates that fraud can be inferred from the allegations of the complaint. He fails to point out any allegation that supports such a suggestion. Indeed, there is none.

The Answer.

The answer consists of a general denial and five separate defenses (R., pp. 42-72). Those defenses are:

(1) Plaintiff has failed to comply with the provisions of Federal Equity Rule 27 (R., pp. 49-50).

(2) The stockholders of the Company, including plaintiff, have ratified the payments made to the de-

fendants in accordance with and under the authority of Article XII (R., pp. 50-52).

(3) The action is an attempt to interfere with the internal management of a foreign corporation engaged in a nation-wide business, the affairs of which are dependent upon the statutes of New Jersey, in respect to many of which there are no decisions of New Jersey courts to serve as a guide in their proper construction and possible interrelation (R., pp. 52-53).

(4) Plaintiff is barred by laches and estopped from maintaining the action. Article XII has been in existence for nineteen years, openly a part of its By-Laws (R., pp. 14-16); the Company and its officers relied upon it in making contracts for their compensation, said officers rendered their services upon the expectation, understanding and agreement that they would be paid in accordance with Article XII, and no stockholder other than plaintiff, and plaintiff not until March 1931, has ever objected to, or taken any action within or without the Company relative to, its validity or the payments made thereunder (R., p. 53).

(5) The amount of compensation paid to the individual defendants was and is fair and reasonable for the services they have rendered to the Company, said compensation was duly earned, under the By-Laws of the Company the Directors had the right to fix the compensation of its agents, and the payments were made in accordance therewith as well as with the authority conferred by Article XII (R., pp. 54-69).

Petitioner, after joinder of issue, made a motion in the District Court (1) to strike out each of the five separate defenses; (2) for a decree declaring Article XII invalid, requiring the individual defendants to account for all payments made to them under that Article, and restraining the Company from making any further payments thereunder;

and (3) in the alternative, for an injunction *pendente lite* restraining any further payments to any president or vice-president under the By-Law (R., pp. 4-5).

The motion was heard on January 15, 1932 (R., p. 3). On March 18, 1932, the District Court rendered an opinion which stated (but gave no reasons for the conclusion) that it was "bound to exercise jurisdiction" and that its impression was that the By-Law was invalid; the Court stated further that its view was only tentative because it did not have an adequate opportunity for investigation and reflection (R., pp. 3, 130).

On March 24, 1932, the District Court (CAFFEY, *J.*), entered its order granting petitioner's motion for an injunction upon the giving or waiver of a bond of $1,000 (R., pp. 131-133).

The defendants appealed to the Circuit Court of Appeals, which reversed the decree of the District Court and disposed of all the issues in the case by its majority opinion which stated in part:

> "* * * The by-law is neither *ultra vires,* fraudulent nor illegal, and since it is not, courts must refuse intervention because they are powerless to grant it. Here the matter of salaries, like that of other corporation affairs, must be disposed of by the majority of stockholders and in the manner that their interests may dictate, and the action of the majority is binding upon all, whether approved or disapproved by the minority. * * * By-Law XII was properly passed and became a valid governing act of the corporation" (R., p. 144).

On June 29, 1932, the Circuit Court of Appeals issued its mandate which reversed the order of the District Court and directed "that such further proceedings be had in said cause in accordance with the *decision** of this Court * * *" (R., p. 150).

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* Italics ours unless otherwise indicated.

On July 8, 1932, the District Court (MACK, *C. J.*), entered a decree based upon the mandate and decision of the Circuit Court of Appeals dismissing each of the bills of complaint upon the merits (R., pp. 150-151). Plaintiff states in his brief (p. 3) that "upon the mandate alone, without any further hearing, the District Court (MACK, *J.*) dismissed the entire case upon the merits." Actually the decree signed by Judge MACK distinguishes carefully between the mandate of the Circuit Court of Appeals and its decision, as the decree, after reciting that a mandate has duly issued from the Circuit Court of Appeals to the District Court reversing the decree of the District Court, recites: "* * * it appearing from the *decision* of the said Circuit Court of Appeals that the said cause was adjudicated by said Circuit Court of Appeals in favor of the said defendants on the merits, * * *" (R., p. 151).

Plaintiff appealed to the Circuit Court of Appeals from that decree of the District Court, instead of applying to this Court for a writ of certiorari to review the first decree of the Circuit Court of Appeals (R., p. 152).

On the second appeal, the Circuit Court of Appeals affirmed the decree of the District Court as in conformity with its mandate and decision on the first appeal (R., pp. 156-157).

Plaintiff, then, on February 25, 1933, filed his petition to this Court for a writ of certiorari "to review the decree entered in the United States Circuit Court of Appeals for the Second Circuit on the 14th day of February, 1933" (the decree on the second appeal).

Summary of Argument.

I. The Scope of the Review.

No question was raised by plaintiff's appeal to the Circuit Court of Appeals from the decree of the District Court entered July 8, 1932, other than whether that decree complied with the mandate and decision of the Circuit Court of Appeals of June 29, 1932. The decree of the Circuit Court of Appeals on plaintiff's appeal, to review which the present writ of certiorari has been granted, presents the single question whether the Circuit Court of Appeals correctly interpreted its previous mandate and decision.

II. The action involves an interference with the internal management of a New Jersey corporation, and as a necessary feature thereof, the construction and interrelation of many New Jersey Statutes, as to which the courts of the corporate domicile afford the proper forum.

III. Plaintiff has failed to comply with Equity Rule 27.

IV. Article XII is legal, *intra vires*, and valid.

(1) There is nothing in the charter that prohibits the payment to the officers or other employes of the Company of compensation measured by its profits.

(2) Under the General Corporation Act of New Jersey (revision of 1896), the stockholders have always had the power to pay officers contingent additional salary measured by the net profits of the corporation.

A. Article XII, duly adopted by the shareholders, created a contract with the officers which is unassailable as to all compensation earned.

B. The complaint does not charge any fraud.

C. Cases cited by plaintiff have no application.

(3) The stockholders of a New Jersey corporation have complete power over its by-laws.

V. Other payments or benefits under later plans which are the subjects of other suits are wholly irrelevant in this suit.

VI. The Court will not substitute its judgment for that of the stockholders and no facts are pleaded justifying interference with the internal management of the Company.

VII. Laches.

VIII. Conclusion.

I.

The Scope of the Review.

No question was raised by plaintiff's appeal to the Circuit Court of Appeals from the decree of the District Court entered July 8, 1932, other than whether that decree complied with the mandate and decision of the Circuit Court of Appeals of June 29, 1932. The decree of the Circuit Court of Appeals on plaintiff's appeal, to review which the present writ of certiorari has been granted, presents the single question whether the Circuit Court of Appeals correctly interpreted its previous mandate and decision.

The majority opinion of the Circuit Court of Appeals on the first appeal held that Article XII "was properly passed and became a valid governing act of the corporation" and that "it was valid, effective and controlling in the allotment of additional compensation to officers of the corporation" (R., pp. 144, 145). That ruling determined in favor of the defendants all the issues presented by the complaint.

Accordingly, the instruction to the District Court contained in the mandate of the Circuit Court of Appeals, "that such further proceedings be had in said cause in accordance with the decision of this Court" (R., p. 150) required the

mandate to be read together with its opinion, and was a final decree of that Court directing the District Court to render judgment dismissing the complaints upon the merits. *Gulf Refining Co.* v. *United States,* 269 U. S. 125, 136. Nothing remained for the District Court, but the ministerial duty of entering a decree to that effect. *Gulf Refining Co.* v. *United States,* 269 U. S. 125, 136; *McGourkey* v. *Toledo & Ohio Railway,* 146 U. S. 536; *Bostwick* v. *Brinkerhoff,* 106 U. S. 3.

The decree of July 8, 1932, of the District Court (MACK, *C. J.*) shows on its face (R., pp. 150-151) that that Court consulted and obeyed the mandate and decision of the Circuit Court of Appeals and entered its decree dismissing the complaint on the merits in accordance therewith. In so doing, the District Court acted correctly. *Gulf Refining Co.* v. *United States,* 269 U. S. 125, 136; *Farmers National Bank* v. *Wilkinson,* 266 U. S. 503; *Toledo Scale Co.* v. *Computing Scale Co.,* 261 U. S. 399; *Mutual Life Insurance Co.* v. *Hill,* 193 U. S. 551; *In re Sanford Fork and Tool Co.,* 160 U. S. 247; *Roberts* v. *Cooper,* 20 How. 467.

On the second appeal the Circuit Court of Appeals could not entertain an appeal from itself to itself, *Aspen Mining & Smelting Co.* v. *Billings,* 150 U. S. 31, 37; *Texas & Pacific Railway Co.* v. *Anderson,* 149 U. S. 237; *Mackall* v. *Richards,* 116 U. S. 45; *Humphrey* v. *Baker,* 103 U. S. 736; *Stewart* v. *Salamon,* 97 U. S. 361; and therefore could only consider whether the decree of the District Court entered pursuant to its mandate and decision upon the first appeal was in conformity therewith.

The Circuit Court of Appeals affirmed, thus determining that the decree of the District Court of July 8, 1932, was in conformity with its mandate and decision on the first appeal.

It is respectfully submitted that this Court is now without power to review the determination of the Circuit Court of Appeals on the first appeal, no application for a writ of

certiorari to review that decree having been made within three months thereafter. Act of February 13, 1925, C. 229, Sec. 8(a), 43 Stat. 936, 940; *Morton* v. *United States,* No. 638, October Term, 1932; *Dubilier Condenser Corporation* v. *Radio Corporation of America,* No. 396, October Term, 1932; *Gotham Can Co.* v. *United States,* 281 U. S. 706; *Hooper* v. *United States,* 274 U. S. 743; *Rust Land & Lumber Co.* v. *Jackson,* 250 U. S. 71.

Since plaintiff's petition for a writ of certiorari sought a review of the decree "entered in the United States Circuit Court of Appeals * * * on the 14th day of February, 1933," (the decree on the second appeal) the instant writ of certiorari to review that decree presents the single question whether the decree of the District Court of July 8, 1932, was in conformity with the mandate and opinion of the Circuit Court of Appeals on the first appeal,—the only question present on the second appeal. *Toledo Scale Co.* v. *Computing Scale Co.,* 261 U. S. 399, 418.

There can be no doubt but that the decree of the District Court of July 8, 1932, dismissing the complaints on the merits, was in conformity with the determination of the Circuit Court of Appeals on the first appeal, in view of the construction of its first decree by that Court on the second appeal.

If there were any doubt, that doubt would disappear upon an examination of the record, which makes it clear that the Circuit Court of Appeals did, by its mandate and decision on the first appeal, dispose of all the issues presented by the complaint on the merits.

II.

The action involves an interference with the internal management of a New Jersey corporation, and as a necessary feature thereof, the construction and interrelation of many New Jersey Statutes, as to which the courts of the corporate domicile afford the proper forum.*

The general right of a court, even where jurisdiction technically exists, to decline jurisdiction in favor of a more appropriate forum is well settled. *Rogers* v. *Guaranty Trust Co., et al.*, 53 Sup. Ct. Rep. 295; *Canada Malting Co., Ltd.* v. *Paterson Steamships, Ltd.*, 285 U. S. 413; *Langnes* v. *Green*, 282 U. S. 531; *Cuba Railroad Co.* v. *Crosby*, 222 U. S. 473; *Heine* v. *New York Life Insurance Co.*, 50 Fed. (2d) 382.

The principles of law determinative of the sufficiency of this defense are completely set forth in the opinion of this Court in *Rogers* v. *Guaranty Trust Co., et al., supra.*

The present cause presents a stronger ground for the declination of jurisdiction than did that case, because the question of compensation fixed by stockholders is a matter more directly affecting the Company's internal affairs than the action of the Directors complained of in that cause and because there are, in addition to the New Jersey statutes involved in that suit, the following New Jersey statutes, whose construction, interpretation and interrelation are vital to a decision of this cause, to wit: General Corporation Act, § 11, (L. 1896, ch. 185, § 11), (By-Laws; power to make and alter);

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* Plaintiff's brief (p. 7), in introducing the discussion of discretionary jurisdiction quotes the phrase, "no question of Federal jurisdiction is presented," from the concluding paragraph of defendants' brief in opposition to the petition for the writ of certiorari. The only apparent object of that quotation is to create the impression that defendants have waived the defense set forth in their answer (R., pp. 52-53) of *forum non conveniens*. If that is the object, the quotation is an inversion of the meaning of the paragraph from which it is taken. The paragraph is merely a summary of Rule 38 of this Court. Defendants have never waived that defense, having pleaded it in their answer and argued it at length in the Circuit Court of Appeals on the first appeal.

General Corporation Act, § 17 (L. 1896, ch. 185, § 17, as amended by L. 1901, ch. 119, § 1), (meetings; Voting); General Corporation Act, § 27 (L. 1896, ch. 185, § 27, as amended by L. 1908, ch. 84, § 1); L. 1932, ch. 192, (Amendments to Chapter 175, L. 1920).

The very wording of the injunction order of the District Court (CAFFEY, *J.*) establishes conclusively that the action involves the internal management of the Company. The order enjoins only "The American Tobacco Company from making any further payments under said by-law to any president or vice-president"; (R., pp. 131-133). Such an order is clearly within the definition of what constitutes the internal affairs of a corporation, in accordance with the opinion of this Court in *Rogers* v. *Guaranty Trust Co.*, and the decisions of the highest courts of New Jersey.

In *Jackson* v. *Hooper*, 76 N. J. Eq. 592, the highest court of New Jersey, in reversing the lower court, said (p. 604):

> "The phrase 'internal affairs of a corporation,' as here used, is well defined in the case of *North State, &c., Mining Co.* v. *Field*, 64 Md. 151, as follows:
>
> > 'Where the act complained of affects the complainant solely in his capacity as a member of the corporation, whether it be as stockholder, director, president or other officer, and is the act of the corporation, whether acting in stockholders' meeting or through its agents, the board of directors, then such action is the management of the internal affairs of the corporation, and in case of a foreign corporation our courts will not take jurisdiction.'
>
> The courts of this state do not possess such jurisdiction, and any suggestion of its assumption we emphatically repudiate."

Petitioner asserts two special reasons why this cause should not be sent into New Jersey, which are:

> (1) The Taylor action was originally brought in the Federal Court, jurisdiction resting on the ground of diverse citizenship.

(2) The District Court, even if it had discretion, exercised it in favor of retaining jurisdiction.

The first special reason is answered by the opinion of this Court in *Rogers* v. *Guaranty Trust Co.*, where it is stated (p. 297):

> "It has long been settled doctrine that a court—state or federal—sitting in one State will, as a general rule, decline to interfere with, or control by injunction or otherwise, the management of the internal affairs of a corporation organized under the laws of another State but will leave controversies as to such matters to the courts of the State of the domicile."

Further, as petitioner concedes, no recovery is sought against Taylor. The suit is in the nature of a declaratory judgment, plaintiff's claim being that Taylor would have been entitled to payment under By-Law XII, if he had not waived that right. This Court has ruled that the Federal Courts have no original jurisdiction of actions for declaratory judgments. *Willing* v. *Chicago Auditorium*, 277 U. S. 274; *Liberty Warehouse Co.* v. *Grannis*, 273 U. S. 70.

The second special reason is answered by the record which shows that the District Court (CAFFEY, *J.*) did not exercise any discretion, as it stated in its opinion granting an injunction, that "this court is *bound* to exercise jurisdiction and that in *Rogers* v. *Guaranty Trust Co., et al.*, E. 59/307, Judge PATERSON* has not held to the contrary." (R., pp. 129-130): The order entered by the District Court, recited, "And it appearing to the Court that the complaint states a cause of action, and that it is *bound* to exercise jurisdiction of said cause"; (R., p. 132). It appears incontrovertibly from the opinion, therefore, as well as from the decree of the District Court, that no discretion whatsoever was exercised.

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* The Court's reason for making that statement is difficult to understand as Judge PATERSON in dismissing *Rogers* v. *Guaranty Trust Co., et al.*, did not consider or refer to the instant case.

Of course, the District Court erred in holding that it was "bound" to exercise jurisdiction (*Rogers* v. *Guaranty Trust Co.*). But, even if plaintiff were correct in his assertion that the District Court had exercised its discretion in retaining jurisdiction, that exercise should have been in accordance with what was right and equitable under the established practice of the court and decisions in cognate cases.

However, the District Court, in this case, reached a conclusion completely at variance with the sound discretion exercised by Judge PATERSON, and upheld by this Court, in *Rogers* v. *Guaranty Trust Co.* That conclusion is, therefore, subject to review and reversal by this Court. (*Lanmes* v. *Green,* 282 U. S. 531, 541-542.) In the last mentioned case it was held that the failure of the District Court to exercise a sound discretion called for the corrective exercise of this Court's appellate authority.

Plaintiff asserts (Pltf's Br., p. 8) that to send this case to New Jersey would be to deny all relief, as it cannot be assumed that the principal defendants would voluntarily subject themselves to the jurisdiction of the New Jersey courts.

The same argument was made in *Rogers* v. *Guaranty Trust Co., et al., supra,* and held to be of no avail. Moreover, in a suit instituted by plaintiff in New Jersey against these defendants and others, following that decision by this Court, all of the defendants have voluntarily appeared.

Aside from that, however, that assumption of plaintiff does not affect the principle involved as the instant case is similar to suits for assessment of stock where the propriety and the amount of the assessment are dependent upon the laws of the State of the corporate domicile and must first be determined by the courts of the corporate domicile and, when so determined, are binding everywhere. *McDermott* v. *Woodhouse,* 87 N. J. Eq. 615; *Glenn* v. *Liggett,* 135 U. S. 533. Therefore, in the present situation, as in the case of

assessments, the issue of the validity of corporate action should be decided by the courts of New Jersey by every rule of justice and reason as well as of convenience. Such a judgment would have to be recognized by every other jurisdiction.

The Company is not one that merely as a matter of convenience, was organized in New Jersey and keeps all or substantially all of its assets and does all of its business in New York. Its activities are worldwide. Its principal office is located in New Jersey and all of its stockholders' meetings are held there (R., pp. 49, 50). It has factories and a number of branches in that State and maintains bank accounts there.

A judgment in New Jersey obtained in a stockholder's suit affecting the validity of the By-Law would be binding in every other jurisdiction. (*Glenn* v. *Liggett*, 135 U. S. 533.) Such a determination would be binding upon the Company, its directors and stockholders, and the judgment *res judicata* against all. *Goodbody* v. *Delaney*, 80 N. J. Eq. 417; *Willoughby* v. *Chicago Junction Railways & etc., Co.*, 50 N. J. Eq. 656.

A judgment rendered by a local court, whether Federal or State, in another jurisdiction would have attached to it all the infirmities pointed out by this Court in *Modern Woodmen of America* v. *Mixer*, 267 U. S. 544, where it said (p. 551):

> "* * * The act of becoming a member is something more than a contract, it is entering into a complex and abiding relation, and as marriage looks to domicil, membership looks to and must be governed by the law of the State granting the incorporation. We need not consider what other States may refuse to do, but we deem it established that they cannot attach to membership rights against the Company that are refused by the law of the domicil. It does not matter that the member joined in another State. * * *"

On the other hand, the courts of New Jersey would not be bound by the construction placed upon the statutes of their State by any other court.

Recently in *First National Bank of Lyndhurst* v. *Bianchi & Smith,* 106 N. J. Eq. 333, the court after referring to a decision of a Federal Circuit Court of Appeals construing a New Jersey statute said (p. 335):

> "* * * But this court is not bound by that decision. In construing state statutes it is the province of our courts to lead, not to follow, those of federal or other foreign jurisdictions."

That decision is in conformity with the case of *Kimball* v. *St. Louis & San Francisco Railroad Co.,* 157 Mass. 7, where stockholders of a Missouri corporation brought suit in Massachusetts to enjoin an issue of bonds which the corporation proposed to sell. The court dismissed the bill, Mr. Justice HOLMES saying (p. 8):

> "But it seems to us clear that, as among the States of this Union, the plaintiffs ought to resort in the first instance to that court which alone can declare the law of the case with authority, and can compel obedience to it by force. It would be a misuse of our powers to attempt to control the action of those courts in a case like this, by an adjudication which would depend upon them for enforcement, and which they might say had mistaken the Missouri law."

A case in point is *Moore* v. *Silver Valley Mining Co.,* 104 N. C. 534, where a suit was instituted by a stockholder to redress wrongs to a Maryland corporation, in which the charter and the by-laws of the company were sought to be interpreted and construed, thus involving questions dependent upon the laws of the State of Maryland, defendant's corporate domicile. In denying relief, the Court said (p. 545):

> "* * * The plaintiff seeks unnecessarily and improperly to bring a foreign corporation into this State

> as a defendant in this action, and have the Courts here interpret its charter and by-laws and the regularity and sufficiency of its proceedings and the laws of the State of Maryland bearing on the same. Ordinarily, the Courts of the latter State properly have the exclusive jurisdiction of such matters and things—this should be settled by the proper Courts there. There is total absence of necessity for such extraordinary procedure here, and the Courts of this State will not unnecessarily entertain an action for such purpose. * * *"

Plaintiff relies upon *Mayer* v. *Oxidation Products Co., Inc.*, 119 N. J. Eq. 141. The facts there were these: A motion for an injunction was sought against directors who had voted salaries to themselves. It appeared that, although the corporation was organized in another State, such incorporation was a mere formality for convenience. All of the property, persons, and officers were in the State of New Jersey. No assets were in the corporate domicile. The Vice Chancellor *denied* the motion for an injunction but indicated that he differed from the ruling of the highest court of the State in *Jackson* v. *Hooper*, 76 N. J. Eq. 592.

Recently in *Hamilton* v. *United Laundries Corp.*, 111 N. J. Eq. 78, the rule laid down in *Jackson* v. *Hooper*, 76 N. J. Eq. 592, was unqualifiedly approved and followed.

Plaintiff relies also on *Ernst* v. *Rutherford*, 38 App. Div. 388. That case involved an illegal appropriation of assets.

III.

Plaintiff has failed to comply with Equity Rule 27.

The complaint does not allege that any demand was made by plaintiff upon the stockholders to take any action with respect to Article XII, or give the causes of plaintiff's failure to seek such action, or any reason for not making the effort. The complaint does not allege that the individual defendants owned or controlled the majority of the outstanding stock of

the Company. The complaint does not allege any unlawful combination of the majority of the stockholders. The complaint contains no allegation that an appeal to the stockholders would be futile or that any emergency existed that warranted plaintiff in not resorting to the stockholders.

The existence of Article XII, *for nearly twenty years,* is proof in itself that no emergency could have been set forth in the complaint.

Article XII provides by its very terms:

> "This By-Law may be modified or repealed only by the action of the stockholders of the Company and not by the directors" (R., p. 38).

Thus, the Company's stockholders have provided, that if any such relief is sought with reference to this By-Law, that relief should first be sought from the stockholders. Plaintiff attempts to violate this enactment without giving the stockholders any vote in this matter so vital to them—and his excuse is that he does so in their interest—but their failure to take the prescribed and easy course open to them of repealing the By-Law shows that they emphatically disagree with him.

The State of New Jersey has an unique statute which in effect provides for a referendum and recall with respect to corporate management.

This statute is Section 46, Chapter 185 of the Laws of 1896 of the State of New Jersey. The germane provisions of that Act provide:

> "* * * three or more stockholders having voting powers may call [a] meeting by publishing ten days' notice of the time, place and purposes of the meeting in a newspaper published in the county in which its principal office in this state is located, and mailing such notice to all stockholders whose post office address is known or can be ascertained; a meeting called as aforesaid shall be a *legal meeting* of the corporation, * * *."

Plaintiff, under that statute, could have joined with any two stockholders to call a "legal meeting" for the purpose of taking action with reference to Article XII. But, in this matter of internal affairs, plaintiff disregarded completely the remedy afforded him under Article XII as well as under the statute law of New Jersey.

In *United Copper Co.* v. *Amalgamated Copper Co.*, 244 U. S. 261, and *Wathen* v. *Jackson Oil Co.*, 235 U. S. 635, this Court has held that Rule 27 must be complied with by a stockholder.

In *Stone, et al.* v. *Holly Hill Fruit Products, Inc.*, 56 Fed. (2d) 553, SIBLEY, *C. J.*, in sustaining a dismissal of the complaint, because of a failure to comply with Rule 27, stated (p. 554):

> "* * * If it had been distinctly alleged that all four of the directors who are joined as defendants were so involved as to make application to them obviously futile, there should have been an effort made through the stockholders to control or supplant them. It is not alleged that there is any wrong combination of a majority of the stockholders, but only that they live at a distance, are ignorant of the situation, and send their proxies to the president. The plain remedy for that would be to seek another stockholders' meeting, after informing the other stockholders of the situation and asking them to withdraw their proxies and to attend. A stockholder, in taking stock in the ordinary corporation, submits, within the charter limits, to a guidance of the corporate affairs according to the will of the owners of a majority of the stock and through the directors whom the majority choose. The minority have a right to have the majority exercise their judgment, and to exercise it honestly and not fraudulently, but have no right to have a court substitute their own ideas and wishes for those of the majority, and that in advance of any refusal of the majority to hear and decide on the matter at issue. Minority stockholders may not in the absence of sudden emergency ask a court of equity

to interfere in the management of their corporation until they have earnestly and unsuccessfully sought redress from the Board of Directors, and where appropriate also from the stockholders in meeting, unless they can show sufficient reasons for not doing so. This is implied in the provisions of Equity Rule 27 (28 USCA Sec. 723)."

To summarize: Article XII was adopted by an overwhelming majority of the stockholders; the defendants had nothing to do with its adoption; the complaint does not proceed upon any theory of fraud; and plaintiff became a stockholder five years after its adoption. Plaintiff does not even allege that the previous owner of the stock which he owns did not vote for its adoption. Under the law of New Jersey, it is essential that complainant show in the complaint that his shares are not burdened by the acquiescence of the previous holders of his stock. *O'Connor* v. *International Silver Co.*, 68 N. J. Eq. 67; *U. S. Steel Corporation* v. *Hodge*, 64 N. J. Eq. 807.

Plaintiff contents himself with meeting the necessity of complying with Rule 27 by an assertion that the by-law is invalid and, therefore, need not be repealed, or if valid, the total compensation is still subject to review and the principle cannot apply. The Rule very specifically states that it applies to "Every bill brought by one or more stockholders in a corporation against the corporation and other parties, founded on rights which may properly be asserted by the Corporation." Cf. *Squair* v. *Lookout Mountain Co.*, 42 Fed. 729, where the Court said (732), "It will not do to permit the complainant's judgment and opinion to nullify and abrogate the rule."

If ever a situation has developed which necessitates the consultation of stockholders, it is present in this case, which involves the compensation of those upon whom the very life of the business depends, and where the stockholders have formally declared that no change or interference with this

underlying principle of compensation shall be made without their vote.

If, under these circumstances, Rule 27 does not apply, it would seem that the Rule has no significance or effect whatsoever.

IV.

Article XII is legal, *intra vires*, and valid.

Plaintiff asserts in this Court that the By-Law is invalid because, as he alleges:

> (1) The charter of the Company granted by the State of New Jersey did not authorize the payment to any officer or other employe of compensation measured by its profits.
>
> (2) Under the General Corporation Law of New Jersey compensation to its officers and other employes, measured by the profits, was not legal prior to the passage of Chapter 175 of the Public Laws of 1920.
>
> (3) The power to make and alter By-Laws of the Company was conferred exclusively on the Directors, and the stockholders had no power to adopt Article XII.

Plaintiff's contentions will be answered *seriatim*.

(1) There is nothing in the Charter that prohibits the payment to the officers or other employes of the Company of compensation measured by its profits.

Article II of the Company's Charter provides, in part:

> "The said merged corporation, in addition to the powers conferred by Section 1 of the Act Concerning Corporations (Revision of 1896) shall have the powers herein set out, and said merged corporation shall be

subject to the limitations on said powers herein set out, * * * (R., p. 18):

* * * * * * * * *

"* * * The directors of said merged corporation shall have the power to fix and determine from time to time and to vary the sum to be reserved, over and above its capital stock paid in, as a working capital, before declaring any dividends among its stockholders, and to fix the time of declaring and paying any dividend, and the amount of any dividend shall be determined by the directors, unless otherwise provided by the by-laws of the corporation; *and to direct and determine the use and disposition of any surplus or net profits or earnings, over and above the capital stock paid in.* All sums so reserved may be applied from time to time to the acquisition of property as the directors shall from time to time determine, and neither the property so acquired nor any of its capital stock held by the corporation shall be regarded as accumulated profits, for the purpose of declaration or payment of dividends, unless otherwise determined by the directors. * * *" (R., p. 19.)

This is the only provision in the Charter which deals with the disposition of surplus, profits, or earnings. Obviously, it does not purport to restrict the power of the stockholders in respect thereto. It does authorize the directors to fix the amount of dividends, if not fixed by the By-Laws, and the amount to be reserved as working capital, but, in addition, it gives the Directors the general power "to direct and determine the use and disposition of any surplus or net profits or earnings, over and above the capital stock paid in." It is axiomatic that Directors have power to hire employes, or else there could be no profits. The right to hire must include the right to compensate. The right to compensate must include the right to determine whether the compensation shall be fixed or contingent or both.

The allegation in the complaint that the Directors were empowered to apply any surplus or net profits or earnings

only to the acquisition of property or to the payment of dividends is in direct conflict with the Charter provisions. Moreover, the Charter of the Company makes use of the words, "surplus or net profits or earnings." There can be no "surplus or net profits" until the expenses of doing business are paid. Compensation to officers, as to any other agents, is an operating expenditure of the Company. It makes no difference whether the compensation is in the form of a fixed salary or measured by the net profits of the Company. It would prevent the employment of agents on a commission basis, a practice as old as history. It would require a precise provision, free from any ambiguity, to justify such an inhibition.

If it be assumed that the Charter so limited the power of the Directors, it would not follow that there would be a like limitation upon the power of the stockholders. It is fundamental that the residual power over corporate funds is lodged with the stockholders, the ultimate owners of the assets of the Company.

The advantage of having stockholders fix the contingent compensation is to remove the subject entirely from the realm of executives who may be affected and thereby to place it beyond the reach of self interest or indiscretion.

Whether Article XII is construed as providing for compensation by a participation in the profits or for compensation measured by the amount of profits, such a provision for compensation would in either event constitute an item of expense in the operation of the business. The right of a corporation to permit profit participation as means of compensation to its officers and other employes is now so well recognized in New Jersey as not to be debatable. *Bennett* v. *Millville Improvement Co.*,* 67 N. J. L. 320; *Booth* v. *Beattie*, 95 N. J. Eq. 776, affd. 95 N. J. Eq. 776.

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*This case was decided by the Court of Errors and Appeals the highest court of New Jersey.

(2) Under the General Corporation Act of New Jersey (Revision of 1896) the stockholders have always had the power to pay officers a contingent additional salary measured by the net profits of the corporation.

The company was organized in 1904. Article XII was adopted in 1912. Article XII provides expressly that the amount to be paid to the six executive officers is to be paid "as salary for the year, in addition to the fixed salary of each of said officers."

The Charter of the Company, in Article II, provides: "The said merged corporation, in addition to the powers conferred by Section 1 of the Act Concerning Corporations (Revision of 1896), shall have the powers herein set out, * * *" (R., p. 18).

Section 1 of the General Corporation Act of New Jersey provides, among other things:

> "Every corporation shall have power:
>
> * * * * * * * * * *
>
> "V. To appoint such officers and agents as the business of the corporation shall require, and to allow them suitable compensation."

The contingent additional salary measured by profits of the Company, expressly described in Article XII as "additional salary" was allowed by the stockholders and comes within the express powers delegated to the Company by the General Corporation Act of New Jersey.

The precise question here presented had already been decided many years before the enactment of Chap. 175 of the Laws of 1920, by the Court of Errors and Appeals of New Jersey in *Bennett* v. *Millville Improvement Co.** (1902), 67 N. J. L. 320.

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* Plaintiff's brief (p. 17) states of *Bennett* v. *Millville Improvement Co.*, 67 N. J. L. 320, that the court that decided it was "not a court of last resort, * * *." The fact is that the Court of Errors and Appeals was then, and is now, the court of "last resort in all causes." (New Jersey Constitution, Article VI, Section I.)

There, plaintiff, employed to construct a glass works for the defendant, and, after its construction, to manage its operations, was to be paid a fixed compensation and one-sixth of the net profits of the company's business. He brought suit for the one-sixth and defendant there relied upon § 47 of the General Corporation Act of New Jersey (L. 1901, Ch. 110, § 2), which provides that:

> "Unless otherwise provided in the original or amended certificate of incorporation, or in a by-law adopted by a vote of at least a majority of the stockholders, the directors of every corporation * * * shall, in January in each year, after reserving over and above its capital stock paid in, as a working capital for said corporation, such sum, if any, as shall have been fixed by the stockholders, declare a dividend among its stockholders of the whole of its accumulated profits exceeding the amounts so reserved, and pay the same to such stockholders on demand."

The contention of defendant in that case that the corporation could not pay compensation based upon the profits, the same contention raised here by plaintiff, was swept aside by the Court, which held (p. 323):

> "* * * But this one-sixth proposed to be given to the plaintiff was salary—payment for services—and not part of the profits, but part of the expenses of the business, and if the corporation had permitted its president, by acquiescence or by receiving the benefit of the services for which this one-sixth was to pay to make this arrangement, then the corporation was as much bound to pay this as to pay the fixed salary which they had agreed to. The profits referred to in Section 47 were not ascertained until this expense of conducting the business had been paid."

Plaintiff criticises the case upon the ground that the Court disregards the distinction between profits and working expenses. But the court expressly recognizes the distinction and holds that a share of the profits paid as compen-

sation falls on the expense side of the ledger. This case states the law of New Jersey governing the internal affairs of a New Jersey corporation. Therefore, plaintiff, as every other stockholder, must abide by the controlling effect of that decision in respect to this Company's internal affairs. Cf. *Rogers* v. *Guaranty Trust Co., et al.,* 53 Sup. Ct. Rep. 295.

Plaintiff cites no New Jersey case in support of his position; there is none; the two cases he cites (*Eyster* v. *Centennial Board of Finance,* 94 U. S. 500, 503; *Harrison* v. *London Assurance Corp.,* 10 App. Cas. 438, 450), have no bearing.

Plaintiff states that his position is based primarily upon the provisions of the Company's charter (Pltf's Br., p. 17). It should therefore be noted that the similarity between the charter of the Company and the statute before the court of last resort of New Jersey in *Bennett* v. *Millville Improvement Co.,* is most marked; indeed it is quite obvious that the charter of the Company was based upon the statute referred to in the *Bennett* case which statute is still in full force and effect.

The right to pay compensation by way of participation in the net profits was recognized and reaffirmed subsequently in New Jersey by the following cases: *Smith* v. *Bedell Bros.,* 84 N. J. Eq. 268; affd. 84 N. J. Eq. 509; *Booth* v. *Beattie,* 95 N. J. Eq. 776, affd. 95 N. J. Eq. 776; *Costello* v. *Thomas Cusack Co.,* 96 N. J. Eq. 95.

In every case, which we have examined, involving the right of a corporation to pay its officers compensation based upon a participation in the net profits, that right has been sustained. Cf. *Harker* v. *Ralston Purina Co.,* 45 Fed. (2d) 929, certiorari denied 284 U. S. 619; *Church* v. *Harnit,* 35 Fed. (2d) 499, certiorari denied, 281 U. S. 732; *Young* v. *U. S. Mortgage & Trust Co.,* 214 N. Y. 279; *Neff* v. *Gas & Electric Shop,* 232 Ky. 66; *Zwolanek* v. *Baker Mfg. Co.,* 150 Wis. 517; *Putnam* v. *Juvenile Shoe Corp.,* 307 Mo. 74;

Ransome Concrete Machinery Co. v. *Moody,* 282 Fed. 29; *Matter of Rosenberg,* 213 N. Y. App. Div. 167, 169.

Plaintiff calls attention to the Act of 1932, Chap. 192 amending Chap. 175 of the Laws of 1920, and says of it (Pltf's Br., p. 19) that "It is evident on the face that this so-called curative act was introduced and passed to meet the very situation developed by this litigation. No Legislature on its own motion would go so far out of its way to pass an act of such limited application."

If plaintiff means that the defendants in the instant case, or any one connected or associated with them, requested that amendment, or had anything to do with it, it is an utterly unfounded inference and entirely contrary to the fact.

Plaintiff lays great stress upon that amendment, and contends of it that it shows that no prior law of New Jersey authorized Article XII.

That contention of plaintiff disregards the controlling authority of *Bennett* v. *Millville Improvement Company,* 67 N. J. L. 320 decided long before the passage of Chapter 175 of the Laws of 1920. Moreover, Section 4 of that Act provides:

> "The privileges and powers conferred by this act shall be deemed to be in addition to and independent of any and all powers and authority conferred by any other law or laws, and not in restriction or limitation of any of the powers now permitted to corporations of this State."

It is a fundamental principle of statutory construction that a legislative body in enacting legislation must be considered to have knowledge of the decisions of its highest court. *Hecht* v. *Malley,* 265 U. S. 144, 153.

If this recent amendment has any significance—and its effect has never been construed by any New Jersey court—it is merely a codification of the case law of New Jersey that it is within the express powers of a corporation to compensate its officers by means of a participation in the profits (cf. *Bennett* v. *Millville Improvement Company,* 67 N. J. L. 320;

Smith v. *Bedell Bros.*, 84 N. J. Eq. 268, affd. 84 N. J. Eq. 509; *Booth* v. *Beattie*, 95 N. J. Eq. 776, affd. 95 N. J. Eq. 776) and that its stockholders have full power to ratify transactions of directors with their corporations. (*Cf. United States Steel Corporation* v. *Hodge*, 64 N. J. Eq. 807; *Endicott* v. *Marvel*, 83 N. J. Eq. 632.)

A. ARTICLE XII, DULY ADOPTED BY THE SHAREHOLDERS CREATED A CONTRACT WITH THE OFFICERS WHICH IS UNASSAILABLE AS TO ALL COMPENSATION EARNED.

The contract between each of the individual defendants and the Company is as binding as any other agreement made between a corporation and its agents.

Article XII calls this additional compensation "salary for the year, in addition to the fixed salary"* (R., p. 14).

The courts do not permit even all of the stockholders to repudiate a contract made between a corporation and employes where the corporation has enjoyed the benefits thereof. A contrary rule would destroy contract rights. *Metropolitan Rubber Co.* v. *Place*, 147 Fed. 90; *Zwolanek* v. *Baker Mfg. Co.*, 150 Wis. 517; *Ginter* v. *Heco Envelope Company*, 316 Ill. 183.

In *Metropolitan Rubber Co.* v. *Place*, 147 Fed. 90, the Circuit Court of Appeals for the Second Circuit, speaking through WALLACE, *C. J.*, held that a by-law of a corporation providing for payment of salary to an officer was in fact an implied agreement by the corporation to pay such salary.

In *Zwolanek* v. *Baker Mfg. Co.*, 150 Wis. 517, plaintiff brought suit to recover a share of the surplus earnings of defendant based upon the following facts: Defendant's by-law provided for the participation by employes in its surplus earnings; pursuant thereto, defendant offered to permit its employes to participate in those earnings provided they re-

* The learned dissenting Judge in the Circuit Court of Appeals was under misapprehension as to the context of Article XII, as he states in his opinion: "The by-law does not expressly say that the payments provided for are by way of additional compensation to the officers, * * *" (R., p. 146).

mained in its employ for a specified period. Plaintiff remained the specified period. He had a written contract which provided for a stated salary, which was silent as to the compensation under the by-law. The stated salary had been paid.

The Trial Court dismissed the complaint, but the Supreme Court of Wisconsin, despite the existence of that written contract, held that the by-law created an unassailable contract between plaintiff and defendant, and said (p. 521):

> "* * * To allow the employer in such a case to repudiate liability on the ground stated would come perilously near conniving at the perpetration of a fraud; and no court should say that in such a case the by-law merely affected the corporation, and not third persons. The rule contended for was not established to meet such a situation, and does not meet it. If corporations desire to have their so-called 'by-law' affect only the corporation and its shareholders, then they should refrain from exploiting them to third persons, for the purpose of inducing such persons to act in reliance thereon."

The fact that Article XII was in existence, and the defendants rendered services upon the expectation and understanding that they would be paid therefor, entitles them to compensation thereunder. *Corinne Mill, Canal & Stock Co.* v. *Toponce*, 152 U. S. 405; *Fitzgerald and Mallory Construction Co.* v. *Fitzgerald*, 137 U. S. 98; *Chandler* v. *Monmouth Bank*, 13 N. J. L. 255; *In re Gouverneur Pub. Co.*, 168 Fed. 113; *Wellington Bull & Co., Inc.* v. *Morris*, 132 Misc. 509, affd. 226 App. Div. 868; *Montana Tonapah Mining Co.* v. *Dunlap*, 196 Fed. 612; *Fox* v. *Arctic Placer Mining & Milling Co.*, 229 N. Y. 124; *Bagley* v. *Carthage, W. & S. H. R. R. Co.*, 165 N. Y. 179; *Zwolanek* v. *Baker Mfg. Co.*, 150 Wis. 517.

B. THE COMPLAINT DOES NOT CHARGE ANY FRAUD.

No fraud is alleged in the complaint and indeed none could be shown.

The Circuit Court of Appeals found:

> "There is no claim in the bill, nor can the argument be maintained, that there was any fraud or collusion in the passage of this by-law between appellants [defendants] who have enjoyed the fruits of its enactment and the corporation" (Record, p. 144).

Neither does the bill allege that this is a case of a majority appropriating the assets of the corporation to the injury of the minority. There is little doubt, but, that if a majority of the stockholders thought it were not for the best interests of the Company that the officers should have this added incentive, they would change it by regular corporate procedure.

In March, 1931, each stockholder was mailed a pamphlet which, in addition to summarizing the provisions of Article XII, gave complete information respecting its operation (R., pp. 88-90), notwithstanding which no stockholder, aside from plaintiff, has taken any steps within or without the corporation to repeal or change it. Since the mailing of that pamphlet, three annual stockholders' meetings have been held, as the by-laws prescribe that the annual meeting of stockholders shall be held on the first Wednesday in April of each year (R., p. 30). It is fair to say that the inaction of the stockholders over the many years of this By-Law's existence is conclusive proof that it and its operation meets with their entire satisfaction.

It is not possible to describe fully within the limited confines of a brief the variety and complexity of the services that the defendants are called upon to render.

Defendant Hill has the general supervision of all the departments of the Company, including sales, advertising, foreign operations, manufacturing, exporting, auditing, and purchasing of leaf tobacco (R., p. 58). His supervision does not mean a mere cursory passing upon the functions of the departments that constitute this great enterprise (R., p. 58); it involves an actual participation in the program of each of

the departments (R., p. 58). He is the executive head and directing genius of the Company.

The late defendant Penn, together with defendant Neiley, had charge of the manufacturing. Under their management, there has been a concentration in the handling of the different tobacco products, a uniformity of production, and an economy of manufacturing. Penn discovered the "Toasting Process" which has resulted in the expulsion of the harsh irritants that had theretofore appeared in cigarettes, and constituted the "bite" in tobacco. He developed machines to distribute the proper amount of tobacco on the cigarette paper so that the cigarette should have the proper weight in accordance with a pre-determined formula; he developed machines for the packing, wrapping and counting of cigarettes (R., pp. 61-62).

Hill and Penn together created the "Lucky Strike" cigarette (R., p. 56), the manufacture and sale of which constitutes a large part of the Company's business.

Defendant Mower was vice-president in charge of the English branch of the business. Under his guidance the sale of cigarettes in England mounted from 365,000 cigarettes per day in 1928 to over 12,000,000 cigarettes per day in 1931, and that at a time when England was in the throes of a depression. His devotion to the Company was such that it resulted in his physical breakdown, which compelled his resignation (R., pp. 63-64).

Defendant Riggio is the vice-president in charge of sales and advertising, responsible for the organization and functioning of the sales department. This department covers the entire country and places the burden upon Riggio of maintaining the sales organization up to the highest degree of efficiency (R., pp. 64-66).

One of the great difficulties and problems of the tobacco industry, and particularly applicable to cigarettes, is the maintenance of the supply of tobacco. Tobacco must be purchased two or more years in advance in order to put it in

proper condition for use in the manufacture of the Company's different products (R., p. 59). This in itself requires an accurate forecast as to the amount necessary for the Company's requirements for two years in advance. It is obvious that if the Company should have a great excess supply of tobacco on hand, due to the failure to anticipate correctly its future needs, the economic effect would be as serious as the failure to have an adequate supply.

The distinctive flavor or "taste" of each brand of the Company's products, whether it be cigarettes, cigars, or pipe tobacco, must be maintained (R., pp. 60, 66). Even tobacco from the same territory varies from year to year as to its quality as well as its peculiar flavor (R., pp. 59-60). Therefore, the greatest care must be used in the purchase of tobacco because to maintain the consistency of the blends, the purchaser of tobacco from any particular territory must take into consideration the variations thereof.

Upon that state of the record the learned dissenting judge in the Circuit Court of Appeals stated that in his opinion the payment of $840,000, "to an officer receiving a fixed salary of $168,000, is presumptively so much beyond fair compensation for services as to make a *prima facie* showing that the corporation is giving away money" (R., p. 146).

But this has not been the opinion of the stockholders of the Company. They determined that compensation, measured by a percentage of the net profits in excess of $11,369,000, provides the necessary incentive to the management for the creation of profits in excess of that sum. How can it be presumed that stockholders of this Company, who have received by way of cash dividends since 1915 over $300,000,000 (R., p. 84-A), are not correct in believing that the application of Article XII was responsible for those profits to them, as well as for the corresponding reward to those who made those profits possible. They may well feel justified in continuing a course which has brought them such great profits.

This Company has undoubtedly many stockholders who own shares in many other corporations. When they look at their portfolio of investments and compare the results obtained for them in this Company with the results obtained from their other investments, the presumption, and the only presumption, is that these stockholders must feel convinced that they have wisely acted in their own best interest in retaining Article XII as a part of the organic law of this Company.

In *United States Steel Corporation* v. *Hodge*, 64 N. J. Eq. 807, the New Jersey Court of Errors and Appeals said (pp. 816, 817):

> "The like view is expressed by the Court of Appeals of Maryland in *Shaw* v. *Davis*, 78 Md. 308, as follows: 'It may be stated as the result of all the authorities, that whenever any action of either directors or stockholders is relied on in a suit by a minority stockholder for the purpose of invoking the interposition of a court of equity, if the act complained of be neither *ultra vires*, fraudulent or illegal, the court will refuse its intervention because powerless to grant it, and will leave all such matters to be disposed of by *the majority* of the stockholders in such manner as their interest may dictate, and their action will be binding on all, whether approved of by the minority or not.'
>
> * * * * * * * * *
>
> As was declared in that case [*Berger* v. *U. S. Steel Corp.*, 63 N. J. Eq. 809] (citing *Ellerman* v. *Chicago Junction Co.*, 4 Dick. Ch. Rep. 217), individual stockholders cannot question, in judicial proceedings, corporate acts of directors, if the same are within the powers of the corporation and in furtherance of its purposes, are not unlawful or against good morals, are done in good faith and in the exercise of an honest judgment.
>
> *Much less can a shareholder challenge like action taken by a majority of his co-stockholders.*"

C. Cases cited by plaintiff have no application.

Plaintiff contends that, under the provisions of the charter, the funds of the Company can be applied only (1) "to put into a reserve fund to acquire property as directed by the board," or (2) "to the payment of dividends," and, therefore, there is a limitation of power which implies the exclusion of all others, including the payment of compensation to its agents measured by its profits.

In support of that contention he cites *Central Transportation Co.* v. *Pullman's Car Co.*, 139 U. S. 24, 28. There it was held that, to measure the powers granted a corporation, its charter must be read in the light of any general applicable laws.

But the general law applicable to every corporation is that it is an implied, if not an express, power of a corporation to pay its officers, agents, and employes compensation based upon a share of the profits. Indeed, in every case in which that question has been presented to the courts, whether Federal or State, that power has been upheld.*

In New Jersey the courts have gone further, and have held that such power is within the express powers granted to a corporation under the statute. *Bennett* v. *Millville Improvement Co.*, 67 N. J. L. 320.

In *Park* v. *Grant Locomotive Works*, 40 N. J. Eq. 114, another case relied upon by plaintiff, the court gave the following sensible definition of "net profits" (p. 121):

> "The words 'net profits' define themselves. They mean what shall remain, as the clear gains of any business venture, after deducting the capital invested in the business, the expenses incurred in its conduct, and the losses sustained in its prosecution."

What can be a more legitimate expense in the conduct of corporate business than the payment of salaries?

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* *Supra*, page 29.

The other cases cited by plaintiff fall into the following categories:

(1) an attempt by a going railroad or business corporation to sell or lease all of its assets to another corporation. *Kean* v. *Johnson*, 9 N. J. Eq. 401; *Black* v. *Delaware & Raritan Canal Co.*, 24 N. J. Eq. 455; *Mills* v. *Central R. R.*, 41 N. J. Eq. 1; *Colgate* v. *U. S. Leather Co.*, 75 N. J. Eq. 229; *Riker & Son Co.* v. *United Drug Co.*, 79 N. J. Eq. 580;

(2) a complete variation in the character of the business for which the corporation was originally incorporated. *Zabriskie* v. *Hackensack & N. Y. R. R. Co.*, 18 N. J. Eq. 178;

(3) a change in the voting rights of the stock. *Lowenthal* v. *Rubber Reclaiming Co.*, 52 N. J. Eq. 440; *In re Newark Library Assn.*, 64 N. J. L. 217;

(4) the substitution of preferred stock for common stock. *Einstein* v. *Raritan Woolen Mills*, 74 N. J. Eq. 624.

(3) The stockholders of a New Jersey corporation have complete power over its by-laws.

The Company's charter, issued in 1904, provides:

> "The power to make and alter by-laws of said merged corporation is conferred upon the directors" (R., p. 19).

Plaintiff's position is that this charter provision emasculates all power in the stockholders over the Company's By-Laws.

But § 11 of the General Corporation Act of New Jersey (Rev. L. 1896, Ch. 185, § 11) provides:

> "The power to make and alter by-laws shall be in the stockholders, but any corporation may, in the certificate of incorporation, confer that power upon

> the directors; *by-laws made by the directors under power so conferred may be altered or repealed by the stockholders.*"

Plaintiff thus disregards completely the plain language of § 11, just quoted, and attempts to construe the charter provision as exclusive.

Article II of the charter provides:

> "II. The said merged corporation, in addition to the powers conferred by Section 1 of the Act Concerning Corporations (Revision of 1896), shall have the powers herein set out, and said merged corporation shall be subject to the limitations on said powers herein set out, to wit: * * *" (R., p. 18).

Section 1 of the Act confers upon every corporation the power:

> "VI. To make by-laws fixing and altering the number of its directors, and providing for the management of its property, the regulation and government of its affairs, * * *."

It is thus clear from the statutes, which govern the Company, that the stockholders had full power to adopt Article XII.

This question has been finally determined by the highest court in New Jersey in *In Re Griffing Iron Co.*, 63 N. J. L. 168, affirmed on the opinion below, 63 N. J. L. 357, where the court declared (p. 171):

> "* * * That the stockholders had delegated to the directors power to amend the by-laws did not curtail their own power to amend them, and of course the later statute [revision of 1896] removed all possible restriction on such power."

Again in the same case the Court said (p. 172):

> "* * * We are referred to numerous decisions that, in the absence of fraud or abuse of trust, stock-

> holders must submit to the control of a corporation by its directors during their term of office. These decisions all relate to collateral attack. They have no reference to direct action of the stockholders taken by legitimate and orderly methods. The right to take such action is inherent, though generally declared and directed by statute. *Thomp. on Corp.*, § 3972. It would be preposterous to leave the real owners of the corporate property at the mercy of their agents, and the law has not done so. Our statute authorizes action by the stockholders under by-laws subject to alteration. Special meetings of the stockholders may be held under the by-laws, or, in case of necessity, under the statute. Sections 1, 2, 17, 46. * * *"

The power to amend includes the power to add or change.

By way of analogy it may be noted that the power to amend the Constitution of the United States includes the power to make additions thereto, such as, e. g., the Eighteenth Amendment. *Rhode Island* v. *Palmer*, 253 U. S. 350; *Christian Feigenspan, Inc.* v. *Bodine*, 264 Fed. 186, 190, affd. 253 U. S. 350.

Plaintiff cites authorities from jurisdictions other than New Jersey in support of his contention that the stockholders of a New Jersey corporation have no power to adopt by-laws for it. Each of the cited cases rests upon a specific statute that confers exclusive power to make by-laws upon the directors. The cases are from Illinois, Indiana, Wisconsin, Oregon, Manitoba, Ontario, and England, and in each instance the court pointed out that the statute had changed the general rule that the power to make by-laws vested exclusively in stockholders.

A typical example is *Manufacturers Exhibition Bldg. Co.* v. *Landay*, 219 Ill. 168, in which the Supreme Court of Illinois held that under the Illinois Statute the exclusive power to make by-laws was vested in the directors. The Court—after it had pointed out that under the common law

it was the duty of the stockholders to enact by-laws—said (pp. 176-7):

> "But where, as in our State, there is a statute specially providing the mode and manner in which a corporation is organized and controlled and its by-laws enacted, under which statute this corporation has its existence, if any particular manner is pointed out by the statute as to the manner in which the by-laws should be adopted we are unable to see how any other legal method could be resorted to."

Plaintiff in his brief states (p. 21), "By-Laws enacted by the stockholders in such case

> 'are lacking in validity or legal force and effect'" (citing Fletcher on Corporations).

To reach that conclusion, plaintiff quotes that single phrase from a sentence, which quotation standing by itself distorts the meaning of the complete sentence, and permits of a perversion of its actual purport.

The full context of that sentence from which the quoted phrase is taken reads (Fletcher, Sec. 4172):

> "It would seem to be the general rule, therefore, that by-laws adopted by the directors or governing body when the power of adoption remains in the stockholders or members, or by the latter when the power of adoption has been delegated to, or vested by statute in, the governing body, are lacking in validity or legal force and effect."

But the statute of New Jersey, differing from the statutes of the States of Illinois, Indiana, Wisconsin, Oregon, etc., provides expressly that the stockholders have complete power over by-laws. In *Re Griffing Iron Co.*, 63 N. J. L. 168, aff'd 63 N. J. L. 357.

Likewise, *Thompson on Corporations* (Sec. 1018), relied upon by plaintiff, states that the power to adopt by-laws is

by common law and general law, unless otherwise provided by statute, lodged with the stockholders of a corporation.

In *Lillard* v. *Oil, Paint and Drug Co.*, 70 N. J. Eq. 197, 206, the Court pointed out that, if the stockholders had no power to fix the compensation the corporation might not be able to employ any director as an agent against the objection of any stockholder.

Plaintiff cites the decision of the Vice-Chancellor in *Scott* v. *P. Lorillard & Co.*, 108 N. J. Eq. 153, and quotes from a dictum contained in the opinion, which was so obviously contrary to the opinion of the Court of Errors and Appeals that, in affirming that decision, the Court said (*Scott* v. *P. Lorillard & Co.*, 109 N. J. Eq. 417):

> "The reasons for our determination are as stated in the opinion filed in the court below * * *; except however as to such part thereof as expresses an apprehension that the passage of the disputed by-law by the stockholders was beyond their jurisdiction and was an encroachment on the powers of the board of directors. The vice-chancellor's observations in that respect are not essential to the conclusion reached and as to them we reserve opinion."

Plaintiff contends that Article XII cannot bind the holders of Common Stock B. This stock came into existence eight years after Article XII was adopted and had become an integral part of the Company's organic law. As a fundamental principle of corporate law, the holders of Common Stock B, just as the holders of Common Stock, are bound by all of its by-laws. *Baumohl* v. *Goldstein*, 95 N. J. Eq. 597; *Kavanaugh* v. *Commonwealth Trust Co.*, 223 N. Y. 103, 107; *Richardson* v. *Devine*, 193 Mass. 336.

In *Kavanaugh* v. *Commonwealth Trust Co.*, 223 N. Y. 103, the Court said (p. 107):

> "When a by-law is adopted, it is as much the law of the corporation as if its provisions had been a part of the charter. (*Kent* v. *Quicksilver Mining Co.*, 78 N. Y. 159, 179; *Hun* v. *Cary*, 82 N. Y. 65)."

In *State* v. *Shaw*, 103 Ohio St. 660, the Supreme Court of Ohio said (p. 669):

> "* * * When stockholders subscribe to stock in a corporation they are deemed to know the statutory law governing corporations, and *they are also deemed to know the provisions of the corporation's rules and regulations*, and they therefore impliedly, if not expressly, agree to abide by such regulations. Such regulations have been uniformly recognized as essential to orderly action in the business of the corporation and they would become a farce and worse than a plaything if not recognized and enforced."

Plaintiff's position amounts to this: In this case he asserts that the stockholders had no right to fix the compensation of the directors who were employes. In *Rogers* v. *Guaranty Trust Co., et al.*, 53 Sup. Ct. 295, he asserted that the directors had no right to fix their own compensation. If the directors cannot fix their own compensation as officers with the approval of the stockholders, and if the stockholders cannot fix such compensation, then how can the Company function? *Cf. Lillard* v. *Oil, Paint and Drug Co.*, 70 N. J. Eq. 197, 206.

As was said by this court in *Rogers* v. *Guaranty Trust Company*, the plaintiff, as any other stockholder in buying into the Company "impliedly agreed that in respect of its internal affairs the Company was to be governed by the laws of the State in which it was organized. His rights, whatever the tribunals chosen for their vindication, are to be determined on the ascertainment and proper application of New Jersey Law."

A proper application of the New Jersey Law compels the conclusion that the stockholders had full power to adopt Article XII.

V.

Other payments or benefits under later plans which are the subjects of other suits are wholly irrelevant in this suit.

The plaintiff alleges other payments and benefits whose validity he neither admits nor controverts in the complaints in the present cause but which he says are the subjects of other suits (R., p. 14).

He prays for alternative relief, i. e., either—

(1) the adjudication of the invalidity of By-Law XII, with incidental relief, or

(2) if the By-law be held valid, that the court fix and determine as an alternative measure of relief the fair and reasonable compensation of the officers of the corporation for present, past and future services, and award relief incidental to such determination (R., p. 13).

The payments under the corporate By-Law enacted by the stockholders themselves are automatic. No action by the directors is required. Indeed the By-Law provided that it "may be modified or repealed only by the action of the stockholders of the Company and not by the directors" (R., p. 15). If this By-Law be valid, no subsequent plans for compensation can operate to repeal it.

It may be contended that the compensation thus determined by the By-Law has some bearing on other payments or benefits under later plans, but such other payments or benefits can have no bearing on the validity of the By-Law or the payments thereunder.

Since the plaintiff in other suits is attacking the validity of such other payments and benefits, he is not entitled to have them considered in this suit for any purpose.

He has elected to attack the different payments and benefits separately, the By-Law and the payments thereunder

in this suit, the benefits under the stock subscription plan in another suit, the so-called cash credits in still a third suit. If he wished to attack them in the aggregate, he should have joined in one suit the attacks which he has seen fit to make in separate suits.

Having attacked the other payments and benefits in separate suits and having expressly disaffirmed any attack upon them in this suit, they should receive no consideration and be given no effect whatever in this suit. Otherwise it is manifest that great injustice might result.

Wherefore we submit that this suit should be considered as involving solely the validity of the By-Law and the payments thereunder.

VI.

The Court will not substitute its judgment for that of the stockholders and no facts are pleaded justifying interference with the internal management of the Company.

The plaintiff cites many cases on pages 24 and 25 of his brief in support of the proposition that it is "the province of equity to revise excessive salaries and fix the reasonable compensation of officers." None of them support that proposition, which it is submitted is contrary to the settled rule that the courts will not interfere in the internal management of a corporation in the absence of fraud, actual or constructive, or of some element tantamount to fraud.

This case is absolutely barren of any such element. The individual defendants had no hand whatever in the passage of the By-Law. They accepted employment on the faith of it long after its adoption. There is no pretense that they now have or ever had anything like stock control. There is no pretense that in adopting the By-Law or in retaining it since its adoption the stockholders were actuated by any motives

whatever except the best interests of the corporation and the entire body of stockholders.

This is not a case of the diversion or use of assets for other than corporate purposes, of oppressive or unfair action by a majority of stockholders towards a minority, of directors constituting a controlling majority voting extra compensation to themselves, of the appropriation of earnings by directors without a vote of stockholders, or of paying dividends to a self-selected group under the guise of salaries. In truth the case has not a single one of the different elements which have moved courts of equity to interfere in a matter of internal management.

The stockholders, by practically a unanimous vote of those represented at the meeting, decided to give the management extra compensation in the way of profit sharing as an incentive to greater effort and more intense concentration on the business of the company. They fixed the rate at 10%—2½% for the president and 1½% for each of five vice presidents. They fixed the base as the amount of excess earnings, especially attributable to the management, above those from that part of the business for the year, prior to that in which the By-Law was adopted, after deducting an amount sufficient to pay dividends on the preferred stock.

No one would suggest that such action of the stockholders was so unreasonable or excessive as to justify the imputation of fraud. The manifest purpose was to stimulate effort with the view of increasing profits for all the stockholders. The stockholders and the management would profit therefrom in the ratio of nine to one. Certainly the plan cannot now be attacked on the ground that it has been too successful. The stockholders may have profited even beyond their expectations and doubtless that accounts for their contentment. But if they are content, it is not for a court of equity to intervene simply because the plan has succeeded even beyond expectations.

The stockholders reserved to themselves the right to modify or repeal the By-Law and expressly took that right away from the directors (R., p. 15). Three stockholders can call a meeting at any time. At such a meeting or at any annual meeting the By-Law can be amended or repealed. A court may think that the amount received by the management is too much. It may be large, but so have been the resulting profits to the stockholders amounting to over nine times as much. If the stockholders, having the powerful motive of self-interest, are content, it is not for a court to assert some supervisory power which it is not equipped or qualified to exercise.

The plaintiff has quoted from Berle and Means "The Modern Corporation and Private Property," but he overlooks passages much more pertinent to the case in hand, of which we give an example (pp. 342-343):

> "In the modern corporation, with its separation of ownership and control, these two functions of risk and control are, in the main, performed by two different groups of people. Where such a separation is complete one group of individuals, the security holders and in particular the stockholders, performs the function of risktakers and suppliers of capital, while a separate group exercises control and ultimate management. In such a case, if profits are to be received only by the security holders, as the traditional logic of property would require, how can they perform both of their traditional economic roles? Are no profits to go to those who exercise control and in whose hands the efficient operation of enterprise ultimately rests?
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> * * * * * * * * *
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> "Furthermore, if all profits are earmarked for the security holder, where is the inducement for those in control to manage the enterprise efficiently? When none of the profits are to be received by them, why should they exert themselves beyond the amount necessary to maintain a reasonably satisfied group of stockholders? * * * Certainly, one cannot escape the

> conclusion that if profits have any influence as a motivating force, any surplus which can be made over a satisfactory return to the investor would be better employed when held out as an incentive to action by control than when handed over to the 'owners' who have surrendered control."

Whatever may be thought, as a matter of economics, of the proper division of profits between management and stockholders, as a matter of law the stockholders acting fairly and in the interest of all have the right to give the management a contingent extra compensation measured by a share of profits and in the absence of fraud, either actual or implied, or of some element of oppression or of overreaching on the part of the majority, it is not for the courts to interfere even though they may think that the stockholders have been too liberal.

The profit-sharing rate fixed by the stockholders is not large, especially since it is computed only on profits from the part of the business most affected by management in excess of such profits the year before the adoption of the By-Law, after providing for the dividends on the Preferred Stock.

If the resulting extra compensation be thought large, that is due to the phenomenal results attributable to the management. Certainly it is for the stockholders to judge the relation of cause and effect and to determine whether they wish to hazard a continuance of the phenomenal success of the Company upon a change of policy.

The proper forum for the plaintiff to present his case is a stockholders' meeting. If he should lose his case there, the decision would be final in the absence of some showing that the stockholders were governed by improper or ulterior motives and did not fairly act in the interest of all. Certainly he has no standing in a court of equity until at least he has exhausted his remedy within the Corporation.

There is no case in the books in which the courts have ever interfered with a compensation fixed by majority stockholders who were independent of the management.

Indeed, the cases cited by plaintiff (Pltff's Br., pp. 24-25) are authorities in favor of non-interference under the circumstances of this case.

For example, the following cases hold that, where the majority stockholders have acted, a minority stockholder has no cause of complaint. *Church* v. *Harnit,* 35 Fed. (2d) 499; certiorari denied, 281 U. S. 732; *Ransome Concrete Machinery Co.* v. *Moody,* 282 Fed. 29; *Putnam* v. *Juvenile Shoe Corp.,* 307 Mo. 74.

In *Church* v. *Harnit,** 35 Fed. (2d) 499, certiorari denied, 281 U. S. 732, the facts were these: Plaintiff, a minority stockholder, brought suit against four out of five directors of the defendant, to recover bonus payments made for many years under the following circumstances: At the end of each fiscal year, the president, one of the defendants, prepared a schedule of bonus payments to be made to himself and to other officers and employes. The board of directors, the president not voting, then voted upon the bonus, approving the amount suggested by the president for himself. After that meeting, the president authorized the payment of the bonuses fixed for the three other directors as well as for the other employes. The officers were paid also a stated salary fixed by the directors. The Circuit Court of Appeals, for the Sixth Circuit, in finding for the defendants, said (p. 501):

> "* * * The business was managed with marked efficiency. Each of the defendants applied himself with peculiar energy and ability to his particular task.

* That case is of particular interest because an examination of the record discloses that the four defendant executives received from 33.18% to 47.08% of the earnings as compared to the stockholders, who received by way of cash dividends 15.04% to 44.93% of the earnings, whereas, in the instant case, the combined compensation to the executives of salaries and compensation under Article XII ran from 3.03% to 6.47% of the earnings, and the cash dividends were never under 60.45% and reached a maximum of 95.75% of the earnings of the Company (R., pp. 9, 84, 84A).

> Each served through the succeeding years with the understanding and expectation that he would receive additional compensation if his loyalty and industry merited, and the success of the business warranted, such allowances. The company would now be estopped to deny that such was the contract of employment. *Letta* v. *Cincinnati Iron & Steel Co.*, 285 F. 707 (C. C. A. 6)."

The Court said of the very contention now raised by plaintiff (p. 502):

> "It is further contended that it was beyond the power of Harnit to enter into such contracts with his subordinates and beyond the power of such subordinates as constituting a majority of the board of directors to approve the allowance of compensation to Harnit. For more than twenty years the contracts of Hewitt, Sinclair, and Hein have been handled by the chief executive, and in the absence of direct action by the board of directors. This had been with the knowledge of the board and with the implied assent of the stockholders. The employment of subordinates comes directly within the apparent scope of the authority of the president, and, when such executive has acted as if so authorized for a long period of years, this court has frequently held that there is an implied ratification, and the contracts of employment will be upheld." (Citing cases.)

The other cases cited by plaintiff (Pltff's Br., pp. 24-25) involve situations where:

> (1) the directors voted compensation to themselves after the services were completed; *Schall* v. *Althaus*, 208 N. Y. App. Div. 103, 106;
>
> (2) the stockholders had no voice in fixing the compensation and the directors voted the compensation to themselves; *Mitchell* v. *United Box Board & Paper Co.*, 72 N. J. Eq. 580, 585; *Gardner* v. *Butler*, 30 N. J. Eq. 702; *Raynolds* v. *Diamond Mills Paper Co.*, 69

N. J. Eq. 299; *McMahon* v. *Bardette*, 106 N. J. Eq. 79, 80; *Stratis* v. *Andreson*, 254 Mass. 536; *Nichols* v. *Olympia Veneer Co.*, 139 Wash. 305; *Sotter* v. *Coatesville Boiler Works*, 257 Pa. 411; *Collins* v. *Hite*, 109 W. Va. 79; *Lowman* v. *Harvey R. Pierce Co.*, 276 Pa. 382;

(3) the compensation voted was in the nature of dividends to the exclusion of other stockholders; *Godley* v. *Crandall & Godley Co.*, 153 N. Y. App. Div. 697, 710; *Scott* v. *P. Lorillard Co.*, 108 N. J. Eq. 153, aff'd 109 N. J. Eq. 417;

(4) the directors were the majority stockholders; *Lillard* v. *Oil, Paint & Drug Co.*, 70 N. J. Eq. 197, 204; *Wight* v. *Beublein*, 238 Fed. 321; *Atwater* v. *Elkhorn Valley Coal-Land Co.*, 184 N. Y. App. Div. 253, 258; *McKay* v. *Swenson*, 222 Mich. 505; *Decatur Mineral & Land Co.* v. *Palm*, 113 Ala. 531, 537; *Backus* v. *Finkelstein*, 23 Fed. (2d) 531, 537."

In *Booth* v. *Beattie*, 95 N. J. Eq. 776, the Court of Errors and Appeals upheld the principle of compensation to an officer of a New Jersey corporation based upon a share of the profits.

Indeed, the courts have repeatedly ruled that questions such as the one here presented, involving corporate internal affairs, belong, in the absence of fraud or breach of trust, within the domain of the corporate body and upon which the stockholders are the courts of last resort. *Consolidated Cement Corp.* v. *Pratt*, 47 Fed. (2d) 90; *Bisbee* v. *Midland Linseed Products Co.*, 19 Fed. (2d) 24; *Robinson* v. *Benbow*, 298 Fed. 561; *Brictson Mfg. Co.* v. *Close*, 280 Fed. 297; *DuPont* v. *DuPont*, 256 Fed. 129, certiorari denied 250 U. S. 642; *Heinz* v. *National Bank of Commerce*, 237 Fed. 942; *Madsen* v. *Burns Bros.*, 108 N. J. Eq. 275; *Elevator Supplies Co.* v. *Wylde*, 106 N. J. Eq. 163; *Kelly* v. *Kelly-Springfield Tire Co.*, 106 N. J. Eq. 545; *General Investment Co.* v. *American Hide & Leather Co.*, 97 N. J. Eq. 214; *Storrs* v. *James Butler Grocery Co.*, 96 N. J. Eq. 359;

Farmers Loan & Trust Co. v. *Hewitt,* 94 N. J. Eq. 65; *Putnam* v. *Juvenile Shoe Corp.,* 307 Mo. 74; *Seitz* v. *Union Brass & Metal Mfg. Co., et al.,* 152 Minn. 460; *Wellington Bull & Co., Inc.* v. *Morris,* 132 Misc. 509, affd. 226 App. Div. 868.

Plaintiff contends that, if there is no relation between the services rendered and the payments made, they amount to a gift. The fallacy in plaintiff's contention lies in the fact that nowhere does he charge that the services rendered by the officers entitled to compensation under Article XII were not valuable or conducive to the results. On the contrary, the record is undisputed that the services rendered by these defendants—and so the Circuit Court of Appeals found—were extraordinarily successful. The resulting profits alone,—particularly over such a long period of time, in the face of strong competition, and despite changing and adverse economic conditions,—demonstrate the value and success of those services.

The defendants earned their compensation. The magnitude of the Company, the diversity of its products, the infinitesimal profit on each item of its merchandise, the alert intensive rivalry of its competitors, all compel the employment of exceptionally able executives. Their worth and value to the Company must be measured by the services rendered and the results produced. Returns to stockholders in the form of annual cash dividends are indisputable facts, and, when those dividends are the fruits of the labor, there can be no better measuring rod or guide for the determination of the value of that labor than the earned profits which make such dividends possible.

In *Jacobson* v. *Brooklyn Lumber Co.,* 184 N. Y. 152, relied upon by plaintiff, the defendants, who were directors and majority stockholders, had voted to themselves salaries after the completion of the services, and had attempted to justify the value of those services by the rise in the market value of the stock. The court found that the corporation had

never promised to pay the individual directors the salaries involved.

What measuring rod could a court use to determine future compensation of officers? Shall a court lay down a rule for stockholders as to the maximum amount of compensation to be paid to its executives—that is, assume to run the business for a corporation? What past criterion can be used as a guide for the future admeasurement of executives' compensation? There is a marked difference between actual, practical working conditions and theoretical dogmas of economy. Great businesses are not run by dogmas but by the most sensitive and delicate practical adjustments. There is even a greater difference between the opinions of those who are financially interested, that is, the stockholders, as to what is a fair compensation for their employes, and the opinions of writers, whose opinions are founded for the most part, if not wholly, upon no practical consideration or experience, and who could hardly assume to know how to sell hundreds of millions of cigarettes a day upon an infinitesimal profit per unit.

Why should not a corporate enterprise be permitted to offer its chief executives the same chances for legitimate financial gain which private enterprises can hold out to them?

This attempt to interfere with the compensation which the stockholders wish to pay its executives is an attack upon the heart of their enterprise. Such interference might be a death blow to their investment.

VII.

Laches.

It is a fundamental principle of equity that a right, if any there be, must be asserted diligently and before there has been a change of position upon the part of those against whom that right is sought to be asserted. *Window Glass Mach. Co.* v. *Pittsburgh Plate Glass Co.*, 46 Fed. (2d) 484;

Haynes & Co. v. *Druggists' Circular,* 32 Fed. (2d) 215; *Atlantic Life Ins. Co.* v. *Rowland,* 22 Fed. (2d) 126; *Backus-Brooks Co.* v. *Northern Pac. Ry. Co.,* 21 Fed. (2d) 4; *Weniger* v. *Success Mining Co.,* 227 Fed. 548; *Marks* v. *Merrill Paper Co.,* 203 Fed. 16; *Collins* v. *Penn-Wyoming Copper Co.,* 203 Fed. 726; *Kessler* v. *Ensley Co.,* 123 Fed. 546; *Edwards* v. *Mercantile Trust Co.,* 124 Fed. 381; *Eiffert* v. *Craps,* 58 Fed. 470; *Jesup* v. *Illinois Cent. R. Co.,* 43 Fed. 483; *Hardt* v. *Heidweyer,* 152 U. S. 547.

Plaintiff's contention that he did not have actual knowledge of Article XII prior to February, 1931, does not countervail the defense of laches. This court has ruled that legal or constructive knowledge is all that is required. *Galliher* v. *Cadwell,* 145 U. S. 368; *cf. Atlantic Life Ins. Co.* v. *Rowland,* 22 Fed. (2d) 126, and *Spiller* v. *St. Louis & S. F. R. Co.,* 14 Fed. (2d) 284. Of course, plaintiff has constructive notice of the By-Law. (See cases cited, *supra,* p. 42.)

Plaintiff admits, and has never denied, that these officers rendered their services upon the inducement and representation that Article XII was a part of their contract of hire. There can be no tendering back to these defendants the energy, the labor, the services, and the ability that they have expended in and upon the affairs of the Company. They cannot be restored to the *status quo.*

After nineteen years a single stockholder seeks to impose his will upon the balance of the stockholders and would constitute himself the sole arbiter of this most important function of internal affairs.

In place of objecting to Article XII, or introducing a resolution to change it, plaintiff has during the many years that he has been a stockholder remained silent and acquiesced in the election of officers entitled to compensation thereunder, and permitted the officers so elected to surrender their opportunities in other fields, all while he himself has received tremendous returns upon his original investment.

On the question of laches see *Dana* v. *The American Tobacco Co.*, 72 N. J. Eq., 44, 49, affd. 73 N. J. Eq. 736, a leading case in New Jersey, the principle of which has been approved by the following cases: *Schuler* v. *Southern Iron & Steel Co.*, 77 N. J. Eq. 60; *Lazear* v. *American Steel Foundries*, 86 N. J. Eq. 21; *Windhurst* v. *Central Leather Co.*, 101 N. J. Eq. 543.

Plaintiff quotes from the opinion in *Endicott* v. *Marvel*, 81 N. J. Eq. 378. This case was affirmed by the Court of Errors and Appeals in 83 N. J. Eq. 632, where the only question decided was that certain transactions constituted a pledge of the corporation's stock by certain of its directors to themselves, and not a sale of that stock to those directors. The court accordingly said that under those circumstances there could be no question of laches in redeeming the pledge. Moreover, the Vice-Chancellor at *nisi prius* referred only to laches in actions where there had never been notice to the stockholders, whereas, in the case at bar, Article XII, was adopted by the stockholders in 1912, and has always been a matter of record. In the *Endicott* case it was also made clear that a contract between the directors and their corporation is not void but voidable, not at the instance of a single stockholder, but only at the instance of the corporation, which must act promptly.

Upon the general proposition of laches, the following New Jersey cases are also of importance: *Dalsheimer* v. *Graphic Arts Co.*, 86 N. J. Eq. 49; affd. 89 N. J. Eq. 210; *Crawford* v. *Lees*, 84 N. J. Eq. 324; *Rabe* v. *Dunlap*, 51 N. J. Eq. 40.

VIII.

Conclusion.

The case presented by plaintiff involves fundamentally the validity of Article XII adopted by the Company's stockholders in 1912. Incidental to that primary issue, the bill asks other relief, viz.: (1) the return of all compensation paid to the individual defendants under Article XII, and (2) a determination by the Court of future salaries of all the officers presumptively entitled to compensation thereunder.

Plaintiff's attack upon the validity of Article XII and his attempt to have a Court supplant the stockholders in fixing compensation of the Company's executives bring to the front the following considerations:

Plaintiff's theory is that a court must assume the responsibility and obligation of fixing compensation beyond which no further or other compensation can be paid to any executive of the Company notwithstanding that the stockholders have determined that compensation. This he would have a court undertake for all future times irrespective of the Company's condition or the nature of the work imposed upon the executives.

A fortiori if the executives should be unwilling to work for the compensation fixed by a court it is but logical to assume that a court would be asked to obtain executives willing and able to undertake for that compensation the responsibilities entailed in the management of this world-wide enterprise with the same satisfactory results. The economic aspects and business policy of a successful going corporation are proper subjects for the stockholders. The assumption by a court of such functions would be extraordinary and impossible.

It is elementary in modern business that any individual or group of individuals can employ an executive on salary or commission or both. Accordingly, a business corpora-

tion, which consists of a group of individuals who contribute only capital, must be permitted to employ agents for an agreed compensation. One who by acquisition of stock joins such a group impliedly agrees that, in respect of its internal affairs, he is to be governed by the rules laid down by the majority. There is no subject more clearly within the province of the group constituting the entity than the compensation of its agents. Any dissatisfied member can present his views before a group meeting to persuade them that he is right.

But the stockholders of this Company have not omitted any act to establish and maintain this rule of executive compensation for the success of their business. The rule was adopted first at an annual meeting with special notice to every stockholder. At that meeting the vote was practically unanimous. The rule has been maintained as a principle of compensation unbroken ever since. This despite all of the plaintiff's attacks, legal or otherwise, which during the last three years have been brought home to every stockholder of record. In order that there could be no possible doubt that every stockholder had full knowledge of the By-Law, the Company mailed to each stockholder in March, 1931, prior to the annual meeting a pamphlet (R., pp. 88-90) which summarized and explained fully the provisions and working of Article XII.

Moreover, the stockholders lifted this rule out of the general run of By-Laws, and it was the only By-Law so treated, by declaring that it could not be amended or repealed unless by their own vote. After all these years of continued operation and even up to date, not a single move has been made to amend or repeal it by any stockholder, except the plaintiff, despite the fact that any three stockholders out of a total of 40,000 could have called for its reconsideration or revision at any time. Such is the background of this Article XII and such the adherence to it by the stockholders of this Company.

If the objection is made that the pay is excessive, that is a matter for decision by the stockholders. Once it be estab-

lished that the stockholders may validly adopt a principle of business by which its executives' compensation shall be fixed, it must follow that the amount of compensation is a matter peculiarly and exclusively within their prerogative.

In this Company, the stockholders have duly exercised their power and have followed a course which has made their business so successful.

The question here presented is not complicated by any features of fraud or deception. *This plan for compensation was not devised or invented by the defendants.* It was designed to accomplish just what it has accomplished—to bring this Company to the fore-front of successful companies of the world. They found it of record when they were elected to their present offices. They have been hired under it for successive years. For years they have rendered their services in reliance upon this inducement as an essential term of their contract of employment. During this period, they have paid heavy income taxes based upon that compensation; have earned large profits for the Company; have paid tremendous returns to the stockholders upon the capital contributed.

Yet, plaintiff, a single stockholder who bought into this Company after Article XII was adopted, seeks not only to destroy the Company's personnel, and shatter its marvelous efficiency, but even to ruin the executives by compelling them to return all compensation paid thereunder, while having the Company retain all the profits; indeed to penalize these defendants for relying upon the good faith of their employers—the stockholders—and for making an outstanding success of the Company.

Respectfully submitted,

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Counsel for Respondents.

APPENDIX A.

Article XII.

Section 1. As soon as practicable after the end of the year 1912 and of each year of the Company's operations thereafter, the Treasurer of the Company shall ascertain the net profits, as hereinafter defined, earned by the Company during such year, and if such net profits exceed the sum of $8,222,245.82, which is the estimated amount of such net profits earned during the year 1910 by the businesses that now belong to the Company, the Treasurer shall pay an amount equal in the aggregate to ten per cent. of such excess to the President and five Vice-Presidents of the Company in the following proportions, to wit: One-fourth thereof, or 2½ per cent. of such amount, to the President; one-fifth of the remainder thereof, or 1½ per cent. of such amount, to each of the five Vice-Presidents as salary for the year, in addition to the fixed salary of each of said officers.

Section 2. If any such office be vacant for a time amounting in the aggregate to one month in any year, so much of the amount provided by this resolution to be paid to the incumbent of such office as its proportionate to the time of such vacancy shall be returned into the general profit account of the Company. If there shall be a change during the year in the incumbent of any office, the amount hereinbefore provided to be paid shall be divided among the different incumbents of such office in the proportion of their respective periods of incumbency during the year, subject to the above provision in relation to vacancies.

Section 3. For the purpose of this By-Law the net profits earned by the Company in any year shall consist of the net earnings made by the Company in its business as a manufacturer and seller of tobacco and its products after deducting all expenses and losses, such provisions as shall be determined by the Board of Directors of the Company for

depreciation and for all outstanding trade obligations, and an additional amount equal to 6 per cent. dividends on $52,459,400 of its 6 per cent. preferred stock, to which profits shall be added, or from which profits shall be deducted, as the case may be, the Company's proportion (based on its stock holdings) of the net profits or losses for the year of its subsidiary companies engaged in the manufacture and sale of smoking tobacco, chewing tobacco, cigarettes, or little cigars, except earnings on preference shares of British-American Tobacco Company, Limited, and shares of Imperial Tobacco Company (of Great Britain and Ireland), Limited.

Section 4. The declaration of the Treasurer as to the amount of net profits for the year and the sum due anyone hereunder shall be binding and conclusive on all parties, and no one claiming hereunder shall have a right to question the said declaration, or to any examination of the books or accounts of the Company, and nothing herein contained shall give any incumbent of any office any right to claim to continue therein, or any other right except as herein specifically expressed.

Section 5. This By-Law may be modified or repealed only by the action of the stockholders of the Company and not by the directors (R., pp. 36-38).